

Social Security: Why Action Should Be Taken Soon

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I. INTRODUCTION

Social Security benefits have been a foundational element of the Nation's economic security system for the last 75 years. In his statement at the signing of the *Social Security Act* in 1935, President Franklin Delano Roosevelt noted that the *Act* is a "law which will give some measure of protection to the average citizen and to his family...against poverty-ridden old age."

Social Security is intended to be only the first of a three-pillar system of retirement income; it is expected to be supplemented by personal savings and employer pensions. Assuring a reasonable living standard during retirement requires adequate contributions from all three pillars. However, because of increasingly inadequate saving by households over their working lifetimes and declines in the provision of defined benefit pensions by employers, many Americans risk reduced living standards during retirement – a risk that is exacerbated by Social Security's projected financial shortfall. Indeed, Social Security's projected financial shortfall also threatens the economic security of other beneficiaries – the disabled, and dependents and survivors of deceased workers, who together constitute one third of the program's 52 million beneficiaries – a share that is projected to increase in the future.

The Social Security Advisory Board notes with concern that it has been 12 years since it first issued a report urging prompt action on the question of Social Security's long-term solvency. While, under current law, Trust Fund interest and assets will allow full benefits to be paid without legislative action until 2037, the severity of the nation's current and projected fiscal situation could undermine the safety net that Social Security provides. The recession has already worsened Social Security's financial outlook. Trust Fund outlays exceeded tax revenues this year instead of in 2016 as projected in the 2009 Trustees' Report. It is now clearer than ever before that the longer that Social Security's projected insolvency remains unaddressed, the greater will be the risk of decline in the living standards of forthcoming generations of retirees, their dependents and survivors, and the disabled.

Many of the policy options for reforming Social Security are well known, and new ones have been proposed since our report was last published in 2005. This report updates the financial situation of the Social Security program with the most current data available and lists how several reform options would affect its solvency over the next 75 years. While this report explains several proposals that address the Social Security solvency problem, the Advisory Board does not endorse any particular option. Instead, we present these proposals in a bipartisan manner.

We again recommend that Congress should act "sooner rather than later" to reform Social Security, mindful of the need for fair treatment of all – retirees, workers, and future generations.

II. SOCIAL SECURITY SOLVENCY

Background of Social Security Financing

Unlike most governmental programs that are funded through annual appropriations, Social Security is funded through earmarked taxes. A permanent provision of law that directs payroll taxes into the Social Security Trust Funds provides the legal basis that allows benefits to be paid without explicit annual appropriations by Congress. The program's ability to meet its benefit obligations each year is dependent on having sufficient revenue to pay scheduled benefits and not on how well it competes with other programs in the annual appropriations process.¹ The law requires the Trustees of the Social Security programs to report annually on the program's ability to meet its obligations in the near term and to evaluate its actuarial status over the long term.²

Since the program's inception in 1935, Social Security's benefits have been based on insured workers' lifetime earnings. The benefit formula is designed to provide a larger income replacement rate to those workers with lower career average earnings than those with higher earnings. During the first 30-plus years of the system, Congress adopted legislation periodically to increase benefits to reflect the impact of price inflation. These *ad hoc* changes also recognized wage growth through adjustments in the benefit tables or formulae. In addition, Congress increased payroll tax rates and the maximum amount of wage earnings subject to Social Security taxes and creditable toward benefits. These tax increases were designed to provide adequate revenues to meet growing projected benefit costs.

In 1972, Congress modified Social Security laws to ensure that benefits and financing kept pace with wage and price inflation. This was accomplished by enacting automatic annual changes to the benefit formulae and to the maximum earnings level for determining benefits and taxes. However, the new system was flawed and resulted in a form of double-indexation during a period of historically high inflation. The rapid benefit growth that resulted left the system with serious short and long-term financing shortfalls. Congress acted to fix the flaws in 1977, adopting another automatic system for adjusting benefits; one which would adjust financing in a way that was less dependent on accurate projections of the absolute level of wages and prices. This new system depended on wage growth exceeding inflation by about 2 percentage points in the short run (and 1.75 percentage points in the long run) in order to generate sufficient financing to meet benefit costs. In actuality, the realized real wage growth fell far short of those requirements.

Major demographic changes were also taking place during that time. Mortality at older ages declined so that beneficiaries received benefits for more years. Fertility rates had already dropped during the mid-1960s to levels that would produce a stable rather than the growing future workforce needed for paying benefits as scheduled under the benefit formulae. Although immigration rates were higher than projected, future projections revealed a net decline in the number of workers per Social Security beneficiary during coming decades. By late 1981, it was clear that payroll taxes would be inadequate to pay benefits beginning in 1982. Congress adopted temporary legislation allowing Social Security to borrow funds from the Hospital Insurance program. It then enacted the 1983 Social Security Amendments, which changed benefits and revenues to re-establish Social Security's actuarial financial balance over the next 75 years through 2058 (Appendix III.)

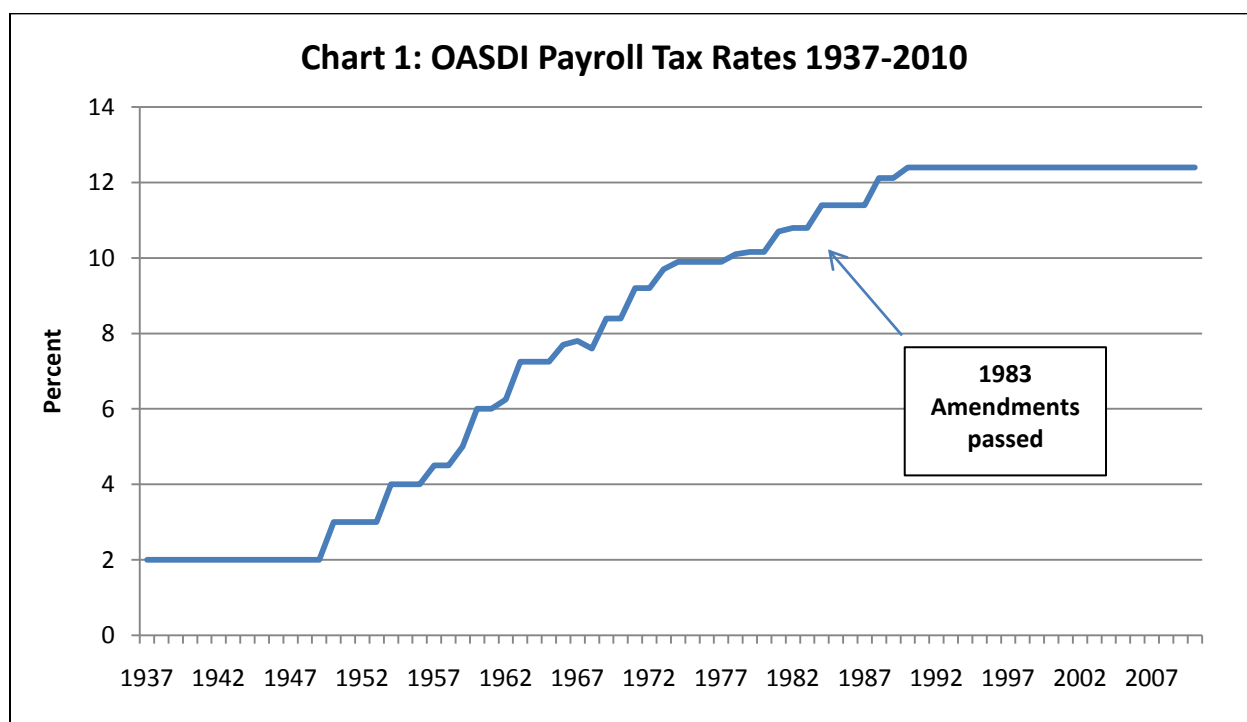
The effect of the 1983 Amendments

The 1983 Amendments achieved actuarial balance with a combination of tax increases, benefit reductions and coverage expansions and they also caused the emergence of Trust Fund surpluses during the initial decades after 1983. Among other provisions, these *Amendments* extended Social Security coverage to federal employees and to elected members of Congress and accelerated already-scheduled OASDI payroll tax increases. The OASDI payroll tax rate was increased in stages between

¹ Revenues to pay benefits are generated through payroll taxes, interest on Trust Fund assets, and income taxation of benefits.

² This report is based on results from the 2009 and 2010 *Trustees Reports*. Some projections in the report such as the financial impact of various reform provisions discussed in Section IV and Appendix 1 are only available based on the assumptions and methods used in the 2009 *Trustees Report*, released in May 2009. Although the 2010 *Trustees Report*, due by April 1, was not released until August 2010, the latest available data have been incorporated into this report.

1984 and 1990. **Chart 1** below provides the full history of OASDI payroll tax rates from the time Social Security was enacted in 1937 to the present.

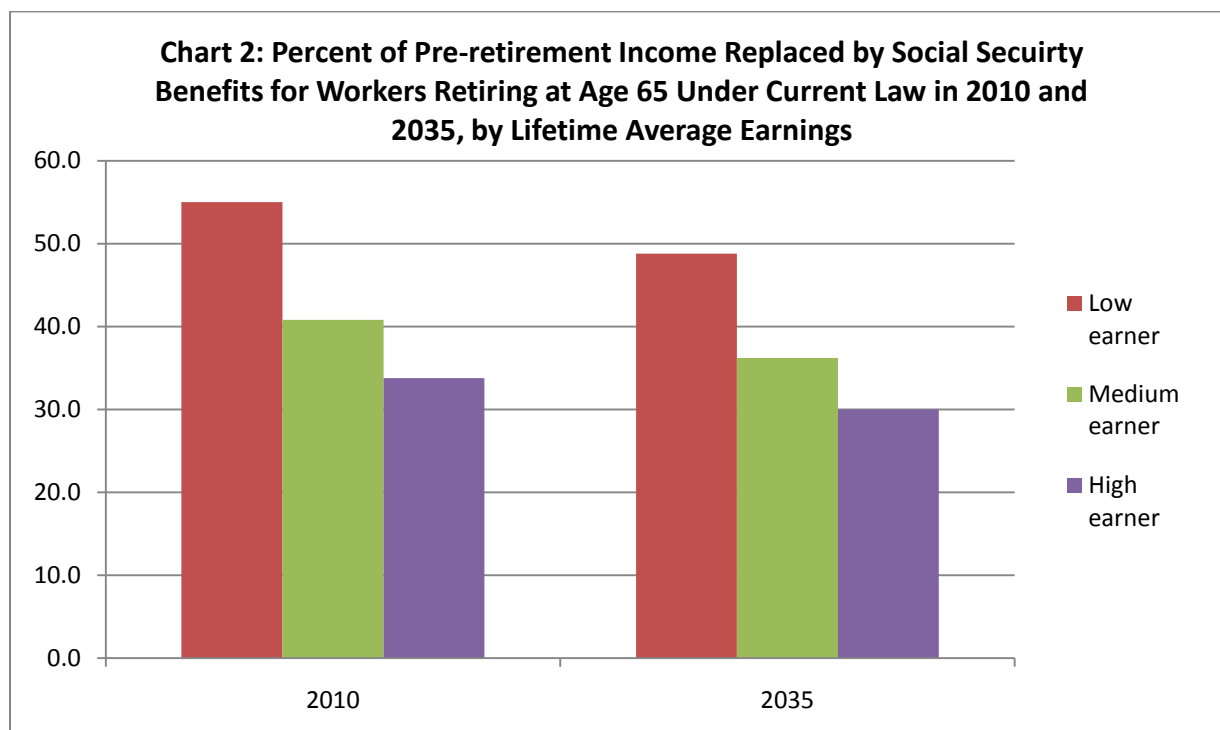


Source: Social Security Administration, *Annual Statistical Supplement of the Social Security Bulletin*, 2009

These same *Amendments* also gradually increased the eligibility age for unreduced benefits from 65 to 67 by 2027. Workers born in 1938 were the first group affected by the gradual increase in the full retirement age, with benefits still available at age 62 but with a larger reduction. This increase in the full retirement age has affected Social Security's replacement rate – the share of annual pre-retirement earnings that are replaced by Social Security's annual benefit.³ As illustrated in **Chart 2**, a low-wage earner retiring at age 65 in 2010 has a replacement rate of about 55 percent; for a high-wage worker the replacement rate is about 34 percent. By 2035, low-wage earners can expect to have approximately 49 percent of their annual pre-retirement earnings replaced by Social Security benefits; higher wage workers will have about 30 percent of their wage earnings replaced.

When the increase in the full retirement age is fully phased in by the year 2023, covered workers will receive only 70 percent of full retirement benefits if they choose to begin collecting benefits at age 62, instead of the 80 percent that those born prior to 1938 received under similar circumstances. At age 65, individuals will receive 86.7 percent of full benefits, rather than 100 percent because their full retirement age would be 67. The net effect of increasing the full retirement age is for individuals who retire before their full retirement age, monthly benefits will represent a smaller percentage of their prior annual earnings. Because life expectancy is increasing, they will receive those smaller annual benefits over what is, on average, a longer lifetime. If replacement rates are calculated at the full retirement age, there is no decrease.

³ The portion of a worker's earnings that Social Security replaces varies according to the worker's wage level; low-wage workers have a higher portion replaced than do higher-wage workers.



Source: Trustees Report, 2010, Table VI.F.10

Increasing the full retirement age has also affected the number of older workers filing for disability benefits. As the full retirement age increases, retirement benefits that are reduced at the earliest age of eligibility become less generous. Disability benefits, on the other hand, are not reduced. Disability benefits for those aged 62 were 25 percent more generous than retirement benefits at age 62 when the full retirement age was 65. When the full retirement age is 66, (for those born 1943-1954), disability benefits are 33 percent more generous, and when it increases to age 67 (for those born in 1960 and later), disability benefits at age 62 will be 43 percent more generous. This increase in relative disability benefits is permanent over the life of the beneficiary, not just until the full retirement age is reached. Research has shown that this incentive does change behavior and makes applying for disability benefits more likely for older workers.⁴ Indeed, the surge in applications to the Social Security Disability Insurance program by older workers during the recent recession may reflect growing public awareness of the more generous treatment of disabled beneficiaries compared to non-disabled early retirees.

Although benefits for people retiring before full retirement age will decline as a percentage of their prior wages, the actual dollar amount of benefits and their purchasing power are expected to continue to rise. (**Table 1**) If wages per worker continue to increase as worker productivity advances, future Social Security benefits will be based on higher wages. The Social Security Trustees expect that, on average, “real” wage growth (the amount by which wages are expected to grow relative to prices) will offset the reductions in benefits caused by the increase in the retirement age.

⁴ Li, Xiaoyan and Nicole Maestas, *Does the Rise in the Full Retirement Age Encourage Disability Benefits Applications? Evidence from the Health and Retirement Survey*, University of Michigan Retirement Research Center Working Paper, WP 2008-198, September 2008.

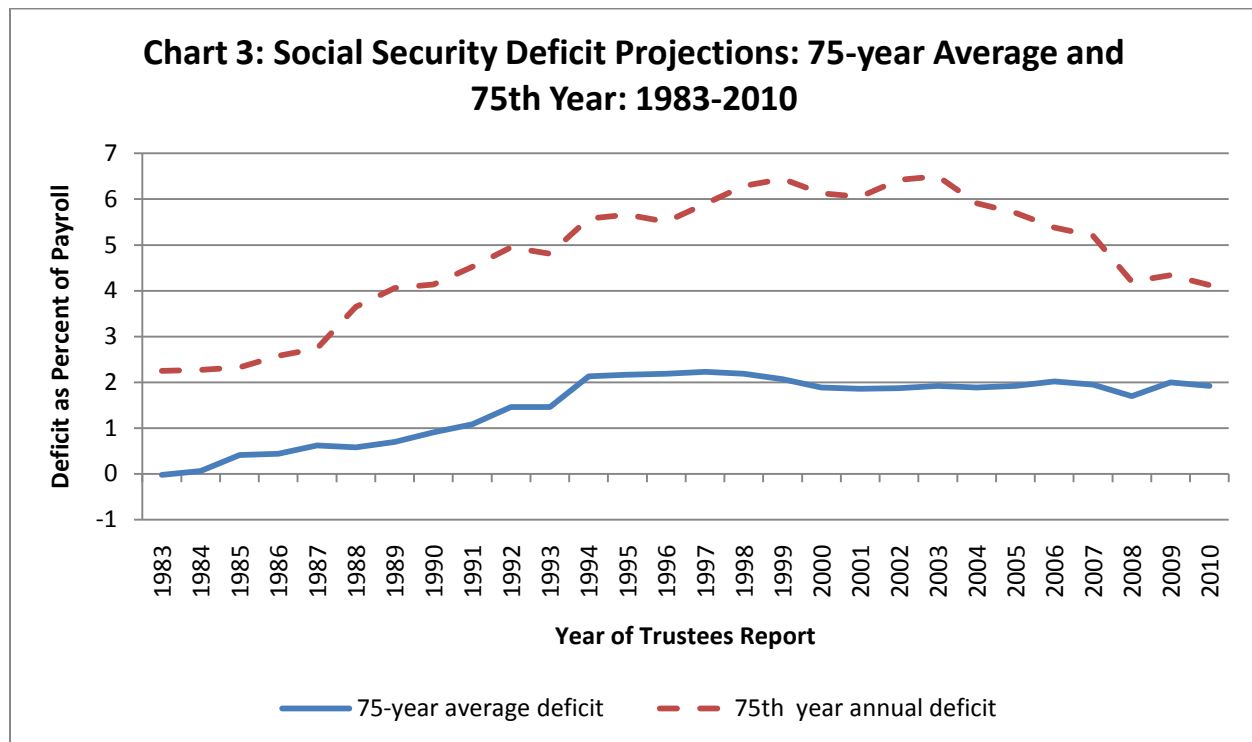
Table 1

Estimated Future Annual Benefits Payable to Workers Who Retire at Age 65 at Various Earning Levels (2010 Dollars)		Low Earner	Medium Earner	High Earner
	Year			
Annual Benefit	2010	\$10,164	\$16,752	\$22,212
Annual Benefit	2035	\$12,633	\$20,817	\$27,590

Source: Trustees Report, 2010, Table VI.F10

Long-term outcomes

Despite the changes made by the 1983 Amendments, the projections of the actuarial deficit over 75 years began to rise almost immediately, growing steadily from 1983 through 2000 to reach a level of about 2 percent of payroll. A major reason was simply that with each succeeding year, the 75 year projection window (or “valuation period”) included one additional year at the end of the period where expenditures greatly exceeded revenue. As shown in **Chart 3**, the projection of the cumulative 75 year deficit (blue line) has held stable hovering around 2 percent of payroll since 1994. The annual deficit in the 75th year of the projection (red line) increased steadily from 1983 until 2004 but has been falling in the projections of the last five or six years owing to changes in assumptions.⁵



Source: Trustees Reports, 1983-2010

Over the last two decades, the Social Security Advisory Board; its forerunners, the Social Security Advisory Councils; and expert panels appointed by the Board to evaluate the assumptions and methods of the projections have all urged that future legislation should seek to achieve “sustainable solvency.” The long-term solvency of the system is thought to be sustainable when there is both a non-negative actuarial

⁵ More recently, alternate views – somewhat more optimistic and much more pessimistic – of the long-term financial status of Social Security projections have been developed. See Congressional Budget Office (CBO), *The Long-Term Budget Outlook*, Chapter 3, March 2010 and Jagadeesh Gokhale *Social Security: A Fresh Look at Policy Alternatives*, University of Chicago Press, 2010, respectively.

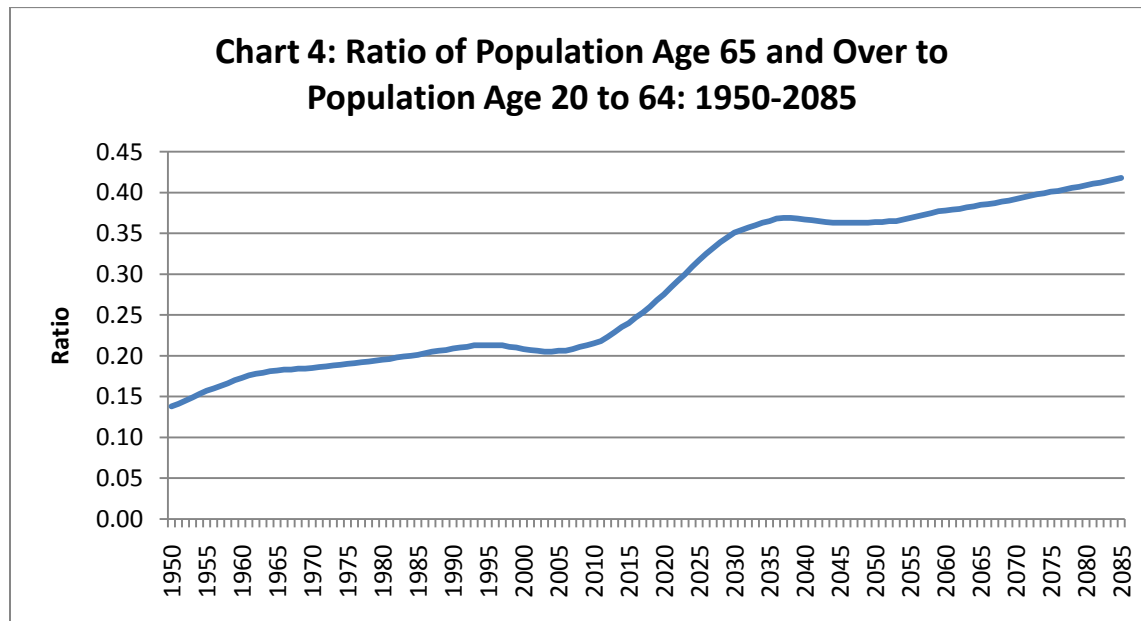
balance over the 75 year valuation period and a Trust Fund that is positive and is either stable or rising as a share of projected annual benefits at the end of the 75 year valuation period. For the past several years, the Trustees' Reports have also noted the importance of this solvency measure for the Social Security system. In 2005, the U.S. Senate unanimously supported the goal of achieving "permanent solvency" for Social Security based on the measure of infinite horizon actuarial balance, which was reintroduced in the 2003 *Trustees' Report*.

If the Trustees' current projections hold, the 1983 reforms will have extended the system's solvency for 54 years with Trust Fund assets plus annual payroll tax revenues sufficient to pay the scheduled benefits during the subsequent year, but those reforms did not achieve *sustainable solvency*. The Trust Funds and revenue during 2038 will not be adequate to pay benefits as scheduled in current law during 2038.

Demographic and Economic Challenges as Baby Boomers Retire

Current 75 year projections of income and spending for Social Security indicate that there is insufficient revenue coming into the program to meet future obligations. Ongoing demographic changes in the United States imply a rapidly growing population of beneficiaries but relatively fewer workers to pay the payroll taxes needed to provide benefits as scheduled under current law. While expansions in coverage, increasing benefit generosity, and actual economic conditions, weaker than projected, have raised the costs of the program over time, the primary driver of the long-range shortfall is the significant change in the age structure of the population that has been anticipated since the late 1960s.

The shift in the relative size of working-aged and elderly populations will take place over the next 20 years. **(Chart 4)** The large numbers of people born during the post-World War II "baby boom" currently make up a large part of the workforce paying Social Security taxes. But they are nearing retirement age; the oldest of the baby boomers (those born in 1946) reached age 62 in the year 2008. By 2030, about 20 percent of the U.S. population is expected to be aged 65 and older compared to about 13 percent in 2009. When the baby boomers transition from working to retirement over the next two decades, the cost of the Social Security program will rise quickly – unless Congress intervenes to change the program's rules.

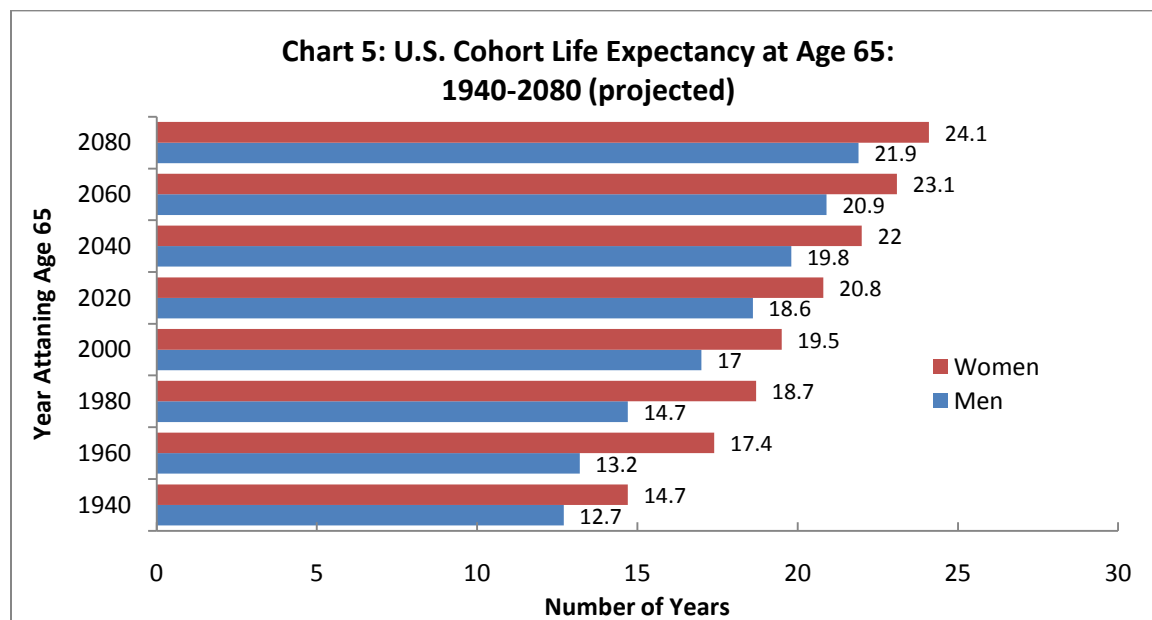


Source: *Trustees Report*, 2010, Table V.A.2

Rising life expectancy

Another factor contributing to increasing retirement costs is that people are living longer. In 1940, when the first Social Security benefits were paid, a man who reached age 65 could look forward to fewer than 13 years of life, and a woman had a life expectancy of fewer than 15 years. By 2030, when nearly all the baby boomers will have reached the Social Security full retirement age, the Trustees project that life

expectancy at age 65 will be over 19 years for men and more than 21 years for women. Longer lives for retirees mean more years receiving Social Security benefits. (**Chart 5**)



Source: *Trustees Report*, 2010, Table V.A.4

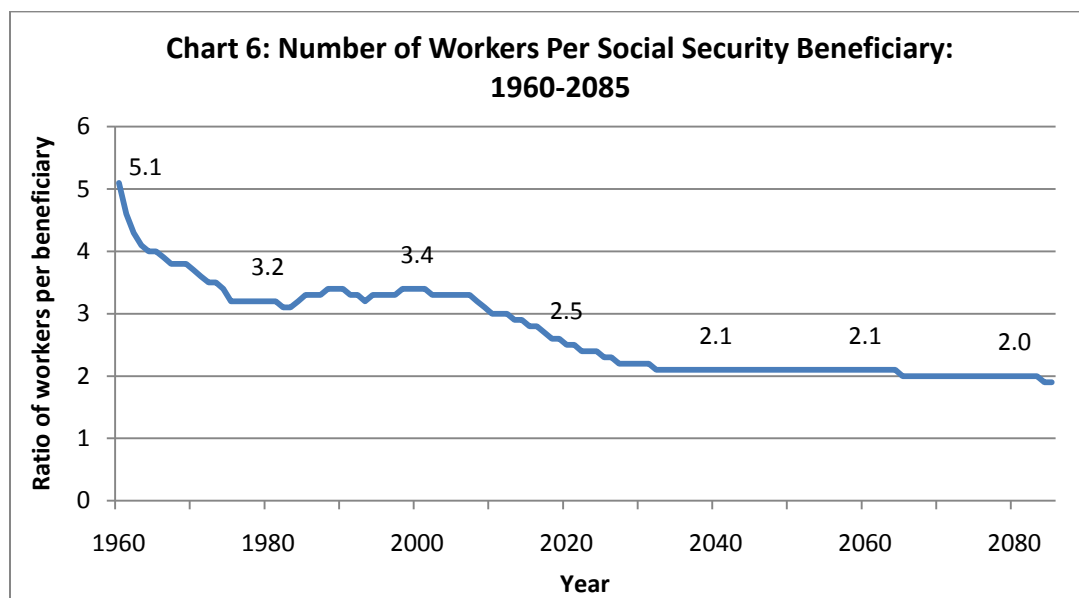
Declining growth of the labor force

The significant demographic changes described above come at a time when the nation is also experiencing a slowdown in the growth of the labor force. The average rate of growth of the labor force slowed from the 2 percent per year it achieved during the 1970s and 1980s to 1.1 percent annually over the period from 1990 through 2008. Projections show this slowdown continuing – to 0.7 percent from 2009 through 2018, 0.5 percent from 2018-2050, and 0.4 percent from 2050-2085.

The major reason for this slowdown is the decline in the birth rate that began in the 1960s. During the mid- to late-1960s, fertility began to decline dramatically. It decreased from above three children per woman from 1947 to 1964 to a low of just 1.74 by 1976. Since then, it has increased somewhat and has been roughly stable at 2.05 to 2.1 over the past decade. Over the long term, the Social Security actuaries project a total fertility rate of 2.0. These lower birth rates will mean smaller future working generations relative to the size of the retiree population.

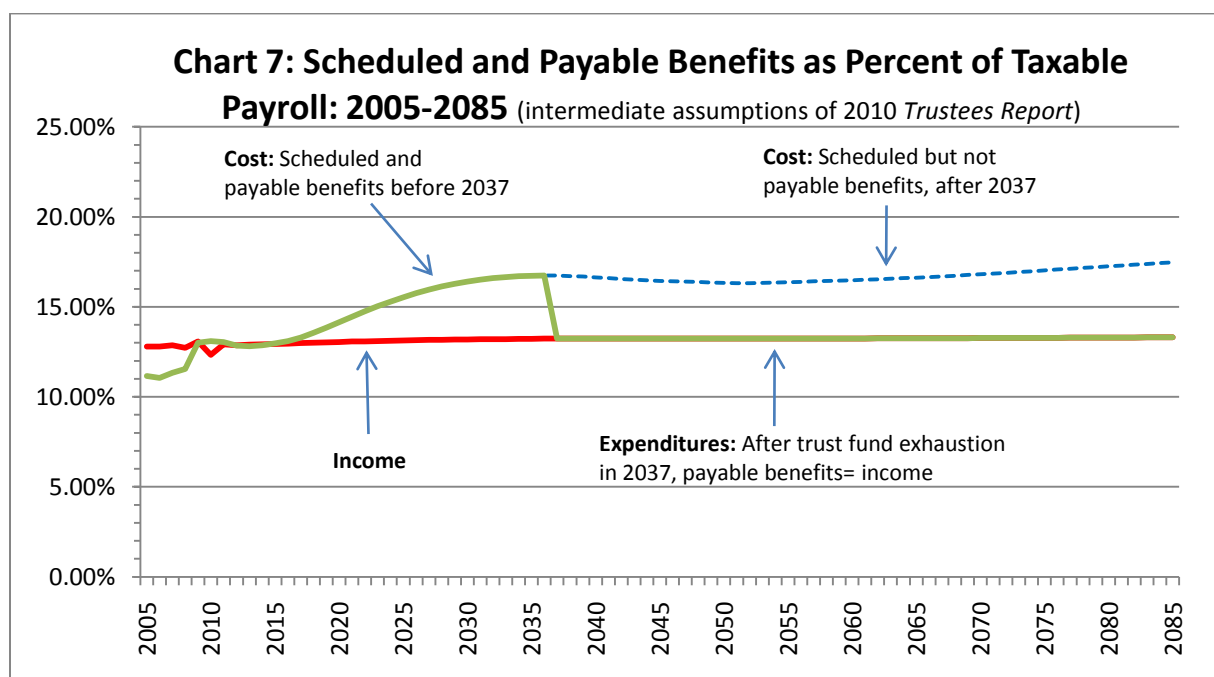
Greater participation in the workforce by women has offset some of the costs of the growing number of Social Security beneficiaries, but this growth trend is not expected to continue. The historical rapid growth trend has actually leveled off. The female labor force participation rate increased from 34 percent in 1950 to 60 percent in 1996 where it has remained up to the present.

Because most of the money used to pay benefits comes from the payroll taxes paid by workers and their employers, the number of workers relative to the number of beneficiaries affects Social Security's ability to meet obligations to beneficiaries. With more beneficiaries and little growth in the number of workers, the ratio of workers to beneficiaries will decline substantially for several decades. In 2010 there were 2.9 workers for every beneficiary. This ratio will decline to about 2.1 workers per beneficiary in 2035. After the year 2035, this ratio will continue to decline slowly, reflecting the increasing numbers of beneficiaries due to assumed increases in life expectancy. (**Chart 6**)



Source: Trustees Report, 2010, Table IV.B2

Because there will be more beneficiaries per worker, there are two main options for balancing projected benefits and revenues. Continuing to meet the cost of currently scheduled benefits under the traditional pay-as-you-go financing arrangement would require a substantial increase in the revenues used to support the program after 2037 – the date of Trust Fund exhaustion. **Chart 7**, drawn using the Trustees' 2010 projections, indicates that the cost of the program as a percentage of current taxable earnings is projected to grow by 33 percent between now and 2084 (from 13.1 percent to 17.4 percent). An exclusively revenue-side change would imply a corresponding increase in payroll tax rates or the level of taxable earnings. Alternatively, with no changes to projected revenues, benefits could be paid under current benefit formulae only through 2037 – the year when the Trust Funds would be exhausted. Benefits would have to be reduced by about 22 percent in 2038 to fit within available revenues. The percentage reduction would grow larger over time so that by 2084 only 75 percent of currently scheduled benefits could be paid.



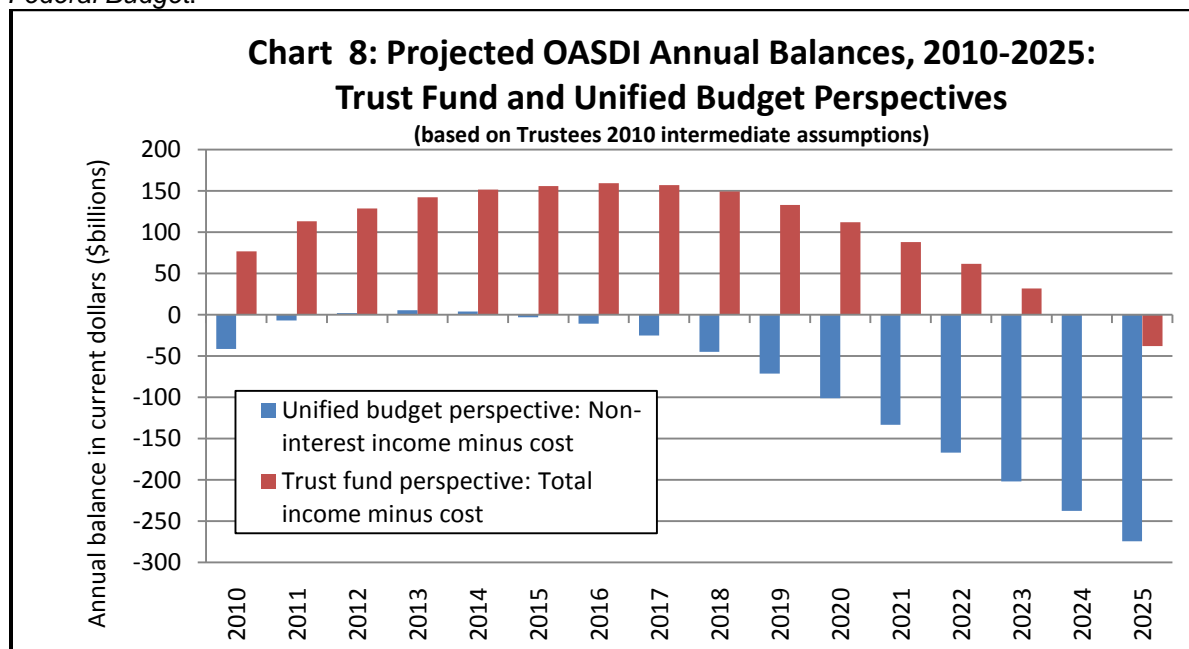
Source: Trustees Report, 2010, Figure II.D2

An uncertainty for the 21st century is whether the demand for labor in the economy will increase the number of jobs available for older workers. Older workers who continue to pay Social Security payroll taxes by remaining in the labor force would reduce the decline in the ratio of workers to beneficiaries and may also reduce the magnitude of the financing problem.⁶ In the last 15 years or so, labor force participation rates for older workers have increased noticeably.

Indeed, current data actually suggest that older Americans are increasing their labor force participation. The recent economic downturn has resulted in many workers losing value in their retirement savings accounts, housing, and other investments. This may be leading some individuals to work longer than anticipated in order to make up for the losses to their retirement assets. According to projections by the Social Security actuaries, an additional 10 percent increase in the labor force participation of individuals age 62 and older by 2011 would improve the long-term OASDI actuarial deficit by 4.5 percent and extend the exhaustion date of the OASDI Trust Funds by one year. The actuaries also project that if the labor participation of both males and females increased in 2011 to the level of workforce participation of males in 1950 (adjusted for corresponding increases in available disability benefits), the actuarial deficit would be reduced by 40 percent, and the date of Trust Fund exhaustion would be extended by 14 years.⁷

Status of the Social Security Trust Funds

The Social Security Trust Funds are the mechanisms used by the federal government to track income received through payroll taxes, interest and other payments as well as the expenditures made for benefits and administrative costs. Past contributions to the Trust Funds that are in excess of the income needed to pay current benefits, the accumulated assets of the Funds, are invested in “special issue” Treasury securities. The cash exchanged for the securities goes into the General Fund of the United States Treasury and is indistinguishable from other cash in the General Fund.⁸ Under current law, the government includes these Trust Fund securities as part of the overall national debt. The financial status of the Social Security program can be examined from two very different, but equally important perspectives; from a *Trust Fund* perspective or from the perspective of its relationship to the *Unified Federal Budget*.



Source: Trustees Report, 2010

⁶An unexplored issue is the effect of globalization which is expected to increase offshore competition for low-wage workers in developed countries. It is possible that the same pressure would dampen demand for older workers with relatively obsolete skills. Testimony of Stephen C. Goss to the Senate Finance Committee, July 15, 2010.

⁷ Testimony of Stephen C. Goss to Senate Finance Committee, July 15, 2010; estimates based on the assumptions in the 2009 *Trustees Report*.

⁸ Social Security Administration's Office of the Chief Actuary, Trust Fund FAQ
<http://www.socialsecurity.gov/OACT/ProgData/fundFAQ.html>.

As required by law, the current and future financial status of the Old Age Survivors Disability Insurance (OASDI) Trust Funds is reported annually by the Social Security Trustees. From this perspective, Social Security is evaluated in isolation of the effect that it has on the overall federal government or the entire federal budget. In contrast, other analysts examine the Social Security Trust Funds from the standpoint of how they fit into the budget of the entire federal government.

The federal government as a whole uses a Unified Budget concept that includes all federal activities without regard to fund-type or whether or not a program is categorized as “on-budget” or “off-budget” for reconciliation purposes. (Social Security was classified as “off-budget” by the 1983 Social Security Amendments, with the intention of protecting benefits from being reduced during Congressional budget reconciliation procedures.) The interest that accrues on Trust Fund bonds is paid out of general revenues. In addition, general revenues are used to redeem the securities held by the Trust Funds at maturity.

Chart 8 illustrates the balance between revenue and costs under the two perspectives. From a Unified Budget perspective, the annual balances were negative in 2010 (because of the negative impact of slowed economic activity on payroll taxes) and by 2015 will begin to show larger and larger deficits each year. The blue bar is roughly the amount of general revenue transfers that would be needed, absent other changes, to pay benefits as currently scheduled. But it should be noted that current Social Security laws contain no provisions for such general revenue financing of scheduled benefits. From a Trust Fund perspective, the inclusion of interest income from the Trust Fund assets means annual balances are positive until 2025, when they begin a sustained decline. In the past, cash flows from general revenues were relatively small. In the near future, they will begin to grow rapidly as Trust Fund assets are increasingly called upon to meet program costs in excess of tax revenues.

Trustees' assessment

In their 2010 report, the Social Security Trustees note that the short term financial outlook for Social Security has been worsened by a deeper recession than was projected last year. The OASI Trust Fund and the combined OASI and DI Trust Funds meet the short-range test of adequate financing that covers the next 10 years. The DI Trust Fund, however, when evaluated independently of OASI, does not meet the short-range test for financial adequacy because its assets are projected to fall below 100 percent of annual expenditures by the beginning of 2013, and to be exhausted in 2018. In 2037, when the combined OASI and DI Trust Funds are projected to be exhausted, OASDI tax income would finance only about 78 percent of scheduled benefits in that year.

The long-range outlook for Social Security has improved slightly since last year, but the combined OASDI Trust Funds still do not meet the long-range (75 year) test for financial adequacy. Under the Trustees intermediate assumptions, the combined OASDI Trust Funds have a projected 75 year actuarial deficit equal to 1.92 percent of taxable payroll. This is 0.08 percent smaller than last year's projection. The primary reason for the smaller deficit in 2010 is the expected effect that the *Patient Protection and Affordable Care Act (ACA)* will have on the rate of growth of the average wage level. The ACA is expected to slow the rate of decline in the share of employee compensation that is paid in wages and covered by Social Security. The introduction in 2018 of an excise tax on high-cost, employer-sponsored health insurance plans will spur employers to reduce compensation through non-payroll taxed health insurance premiums in favor of Social Security taxable wages, thereby increasing the projected growth in the average real wage and payroll taxes.

Implications for the Unified Federal Budget

When viewed from a Unified Budget perspective, monthly cash flows to the OASDI Trust Funds become more significant. When the 2009 *Trustees Report* was released, income from payroll taxes and taxes on benefits was expected to be higher than spending for benefits and administrative expenses until the year 2016, thus the Social Security program was expected to be a net plus for the federal budget. The U.S. Treasury's ability to borrow Social Security's surplus of payroll taxes over benefit payments and use it for other government purposes helps reduce the projected Unified Budget deficit. The budget includes both the General Fund of the government and a number of Trust Funds designated for special purposes, such as the Social Security and Highway Trust Funds.

But in 2009 – due primarily to a deep recession – tax revenues to the OASDI Trust Funds fell below program costs. The Social Security Trustees now project that in 2010 and 2011, annual tax revenues will again fall below annual program costs. Tax revenues will again exceed program costs in 2014, before permanently falling below program costs in 2015, one year sooner than projected in 2009. Unless benefit obligations are reduced before then, the federal government would have to find additional funds elsewhere to meet its obligations fully to Social Security beneficiaries after 2014. In order to pay Social Security benefits that are due under current laws, the government will have to begin paying back sooner the principal of the funds it has borrowed from Social Security by redeeming the bonds held by the Trust Funds. Repaying these bonds requires the federal government to produce extra cash from elsewhere within the federal budget. This extra cash could come from higher non-Social Security taxes, reduced non-Social Security spending, or increased debt held by the public.

Despite the tax revenue shortfall after 2014, Social Security will be able to pay the full amount of scheduled benefits for several years by cashing in Treasury securities held in the Trust Funds, obviating explicit funding legislation by Congress. The exact year in which the currently large Trust Fund will be drawn down to zero depends heavily on prevailing interest rates and other short-range economic and program developments. In 1985, the Trust Fund exhaustion year was projected to be 2049 by the Social Security Trustees. In 1995 the Trustees projected the exhaustion year to be 2030. By 2010, the exhaustion year was projected by the Trustees to be 2037 and by the Congressional Budget Office (CBO) to be 2039. While projections of the exact year of exhaustion may differ slightly, the various projections agree that revenues will begin to fall short of costs, eventually drawing down the Trust Funds to zero. From that point the program will not have income that is sufficient to pay benefits in full. (**Table 2**)

Table 2

Projections of Social Security Deficit	75 Year Deficit (Percent of Taxable Payroll)	Year of Exhaustion	Year Costs First Exceed Revenues	Revenue as a Percent of Costs	
				In 2040:	In 2060:
2010 <i>Trustees Report</i>	-1.92	2037	2015	78 percent	80 percent
2010 CBO	-1.60	2039	2016	80 percent	82 percent
2009 <i>Trustees Report</i>	-2.00	2037	2016	78 percent	82 percent
2009 CBO	-1.30	2043	2017	82 percent	84 percent
2005 <i>Trustees Report</i>	-1.92	2041	2017	76 percent	74 percent
2005 CBO (with Trustees' Long-range Economic Assumptions)	-1.69	2044	2019	75 percent	74 percent
2005 CBO (with CBO Assumptions)	-1.05	2052	2020	78 percent	78 percent
1995 <i>Trustees Report</i>	-2.17	2030	2013	75 percent	72 percent

What Could Happen If Congress Takes No Action Before 2037?

The *Social Security Act* states that every individual who meets program eligibility rules is entitled to benefits. This means that the government is legally obligated to pay scheduled benefits that are currently due and payable to current and future beneficiaries. The Congress has never allowed the finances of the Social Security program to reach the point where scheduled benefits due were not paid.⁹ As a way of

⁹ Congress has in the past and could in the future adjust scheduled benefits to meet existing revenue and/or adjust tax revenue to meet benefit obligations. In the event of Trust Fund exhaustion, the law is unclear whether the Social Security Commissioner or other Trustees have the authority to reduce scheduled benefit amounts in current law. Another possible scenario is that benefits could be delayed reducing the number of full benefit payments during the year. *Social Security: What Would Happen If the Trust Funds Ran Out?* Congressional Research Service (CRS) Report RL33514, August 20, 2009.

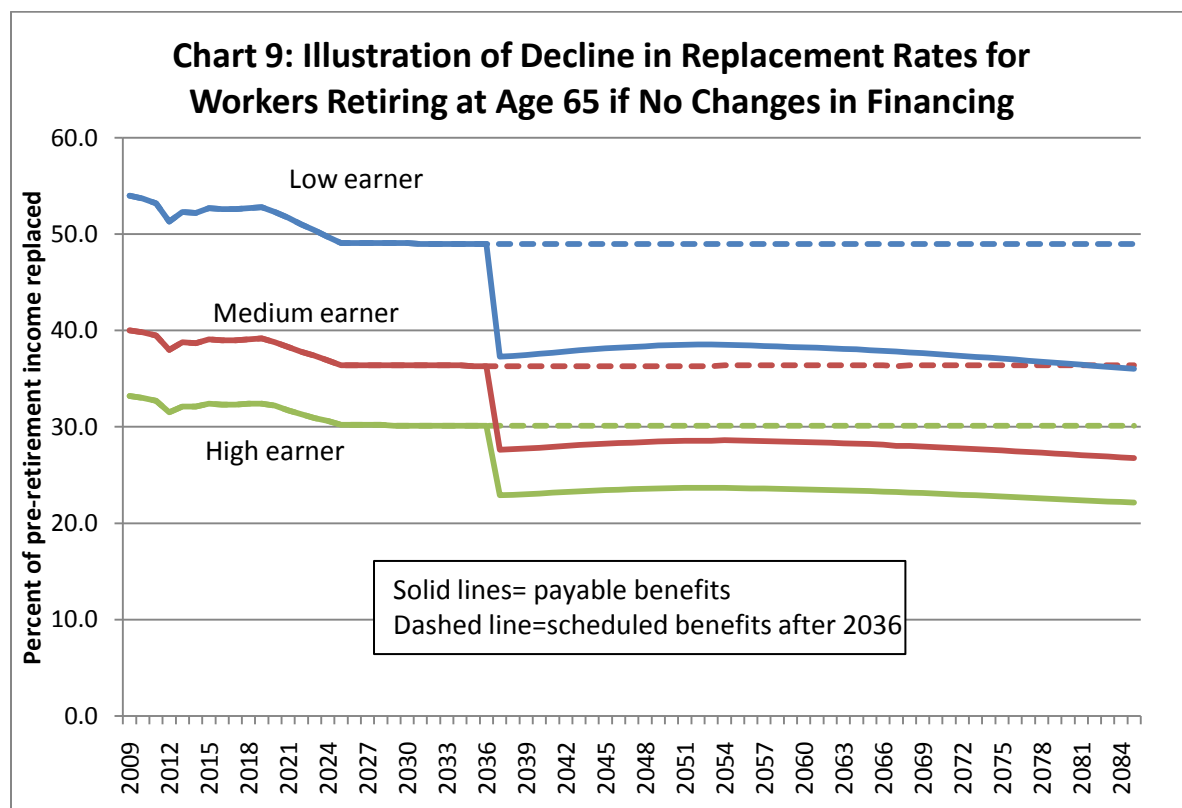
gauging the significance of the projected financing shortfall, it is useful to look at what could happen in the event that Congress takes no action to modify Social Security by 2037. At that point, there would be two basic alternatives – large **immediate reductions in scheduled benefits or tax increases (or some combination of the two)**.

In the analysis that follows, we use the 2009 *Trustees Report* intermediate projections; the overall outlook is the same under the CBO projections.

A hypothetical illustration of the impact of cutting benefits

As described above, the Social Security Trustees project that in 2037 current income to the system from taxes will be sufficient to pay about three quarters (78 percent) of the Social Security benefits that beneficiaries are entitled to receive under current law. This reduction would affect not only those becoming entitled to Social Security benefits in 2037 and later, but also those already receiving benefits at that time. To illustrate:

- The projected monthly benefit for a medium-earning worker retiring at age 65 would fall from \$1,642 in 2036 to \$1,264 in 2037 (in constant 2009 dollars). Benefits for a low earner would drop from \$996 in 2036 to \$767 in 2037.
- Initial Social Security benefits awarded to workers who retired in 2037 and after would replace significantly less of these workers' pre-retirement wages compared to the benefits awarded to those who retired in prior years. As illustrated in **Chart 9**, this "replacement rate" for workers who retire at age 65 would immediately fall:
 - from 49 percent to 37 percent for low earners;
 - from 36 percent to 28 percent for medium earners; and
 - from 30 percent to 23 percent for high earners.
- Benefit cuts could mean that after 2037, the percentage of aged people living in poverty would rise and there would be greater reliance on means-tested or welfare programs, such as the Supplemental Security Income program, which are financed by general revenues.



A hypothetical illustration of the impact of increasing taxes

In order to continue paying full benefits in 2037 and for another 38 years thereafter, Congress would have to change the law to increase the Social Security payroll tax from the current 12.4 percent (6.2 percent each for employers and employees) to about 16.5 percent (8.25 percent each for employers and employees).

In 2037, for a worker earning the estimated average wage of \$57,112 (in 2009 dollars), this would mean an increase in Social Security taxes of \$1,171 a year (from \$3,541 to \$4,712), levied on both the worker and the worker's employer.

Enacting this higher tax rate in 2037 would not be sufficient to ensure that Social Security benefits could be paid for an indefinite period. To ensure that scheduled benefits could be paid in 2084 and beyond, the tax rate would need to be increased in 2084 by an additional 0.3 percentage points (to 16.8 percent). As longevity continues to rise, Congress would need to enact additional tax increases to maintain the ability to pay benefits.

- A tax increase enacted close to the point of Trust Fund exhaustion would have little or no effect on people who have already retired. Their benefits and replacement rates would remain at levels provided in present law.
- However, a tax increase would significantly affect people in the labor force (a group about twice as large as the retired population in 2037). The younger the worker when the tax increase takes effect, the longer and larger the impact would be on lifetime resources and living standards.

III. THE ADVANTAGES OF ACTING SOONER RATHER THAN LATER

The Reasons for Prompt Action

As time goes by, the urgency of the Social Security problem grows, and the choices available to fix it become more limited. There are important reasons for making changes earlier.

- **Ensure confidence.** Workers need to know what they can expect from Social Security. They must have confidence that the programs will remain financially sound and will continue to pay benefits in the future. According to a survey completed earlier this year, only 30 percent of workers polled were very or somewhat confident in the future financial viability of Social Security.¹⁰ A quicker resolution of the program's financial imbalance would eliminate the uncertainty that is currently eroding confidence in the program.
- **Informed retirement planning.** The longer Congress delays action, the harder it is for people to plan for retirement and make decisions that affect their financial well-being. Acting sooner gives people affected by the changes more advance notice so they can make alternative provisions for their retirement such as saving more, working longer, or earning more. If, for example, there is to be a cut in benefits, workers need to know as soon as possible in order to be able to make career and investment choices that will make up for the loss of a portion of their Social Security benefit. The decisions they make will help them avoid the possibility of a substantial reduction in their retirement living standard at a time when they may have fewer career and investment options. If there are to be tax changes, workers and their families may have to adjust their savings or postpone major purchases. Changes in either Social Security benefit levels or tax rates can affect the hiring decisions of employers. Payroll tax increases may cause employers to hire fewer workers and thus limit employment opportunities, including those for older workers.
- **Ability to phase in changes.** Extreme change can be avoided. Implementing modifications to the benefit and/or tax structure can be done in more gradual ways. Smaller changes in Social Security benefits could be phased in over several decades. They would affect more people, but to a lesser degree. The cost of repairing Social Security can be spread more evenly over more generations of workers and beneficiaries. However, the possibilities for distributing this cost across generations will diminish as time passes and has, in fact, diminished considerably since 1998 when the Board released its first edition of this report urging policy makers to act sooner rather than later.
- **Economic stability.** Policy uncertainty creates a negative environment for financial markets in general. Resolving Social Security's financial shortfalls through earlier policy reforms would enhance policy stability and boost economic growth by providing the stable economic environment in which markets operate best. This is particularly relevant in the current environment of massive budget deficits which are projected into the future.

¹⁰ *Retirement Confidence Survey*, Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 2010. See <http://www.ebri.org/surveys/rcs/2010/>.

Illustrating the Effects of Acting Sooner Rather Than Later

There are many ways to fix Social Security and their impact depends on timing. The examples in the following sections illustrate how the effects on both individuals and generations would differ if certain **basic** changes were made effective in 2010 or if they were postponed for the next generation to address in 2037.

Reduce the Social Security cost-of-living adjustment

In each year in which there is a cost-of-living-adjustment (COLA),¹¹ Social Security benefits rise to reflect increases in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).¹² If a reduction in the annual COLA were introduced in 2010, Social Security benefits would be lower for everyone getting benefits at that time and for all future beneficiaries. Thus, both current and future beneficiaries would share in bearing the cost of fixing Social Security. Reducing the COLA in 2037, however, affects only those receiving benefits in and after that year. Most people born before 1945 would not bear any cost of fixing Social Security, and people born in 1975 and later, who could retire at age 62 beginning in 2037, would bear the heaviest costs throughout retirement.

If implemented in 2037, the annual reduction in the COLA would have to be nearly twice as large as the adjustment implemented in 2010 in order to solve the same proportion of Social Security's long-range (75 year) financing gap. More simply, to achieve a similar reduction in the 75 year gap, a 1 percentage point reduction implemented in 2010 – a cut that would be at the very high end of reform suggestions under discussion today – would be needed, while in 2037, COLAs would have to be reduced by 2 percentage points. A 0.3 percentage point cut starting in 2010, which would eliminate 25 percent of the 75 year deficit and be roughly equivalent to basing COLAs on the so-called “chained CPI-U,” would have to be roughly 0.6 percentage points if first implemented in 2037. A larger cut is needed in 2037 because it would apply during fewer years of today's 75 year projection window. Although the total reduction in the program's 75 year financial imbalance would be the same when the policy is implemented in 2037 rather than in 2010, its impact on today's retirees would be smaller; the impact on younger and future generations would be much larger.

Because COLA cuts compound over time, they have a cumulative effect on benefit levels. They would have the greatest impact on those who receive benefits the longest: long-lived retirees and disabled beneficiaries who have non-life-threatening conditions.

Reduce scheduled benefits

One way to reduce program costs is to adjust the Social Security benefit formula for future beneficiaries by lowering the percentage of earnings that is replaced by benefits. A reduction in the formula for determining initial retirement benefits beginning in 2010 would lower the percentage of earnings replaced by benefits for everyone eligible to receive benefits in that year or later, that is, people born in 1948 and after. It would not affect people born earlier and already eligible for benefits.

An across-the-board benefit reduction of about 5 percentage points beginning with individuals newly eligible in 2010 would solve 31 percent of the average shortfall over the next 75 years. If a similar benefit formula change is delayed until 2037, the across-the-board reduction would have to be larger, about 10.5 percent, to have the same impact on the long-range (75 year) actuarial deficit.

¹¹ The Cost of Living Adjustment for a given year is based on the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers measured in the third quarter of the previous year. If the level of prices in the third quarter of a given year is not higher than in the last year a COLA was made, then there is no increase in benefits for current beneficiaries. The level of the CPI was unexpectedly high in the third quarter of 2008 leading to a large COLA in 2009 of 5.8 percent. The level of the CPI in the third quarter of 2009 and 2010 had not yet returned to the level in 2008, so there was no COLA in 2010 and will not be one in 2011.

¹² Some experts believe that the CPI-W currently underestimates changes in the cost of living relevant to Social Security beneficiaries, while others believe that CPI-W overstates increases in the cost of living. Adopting a measure of inflation that reflects more rapid increases the average cost of living, such as the Consumer Price Index for the Elderly (CPI-E), would also increase the future financing deficit. Adopting a measure of inflation that reduces the average increase in cost of living adjustments would reduce the future financing deficit.

A cut for individuals newly eligible in 2037 would reduce retirement benefits for people born in 1975 and later, and would cause them to have substantially lower replacement rates than earlier generations. Changes could be made to the benefit formula in ways that reduce benefits by the same percentage at all income levels or in ways that are not uniform across income levels. If the benefit formula is reduced uniformly across income levels, those with the fewest sources of retirement income outside of Social Security would tend to be impacted more heavily.

Increase the payroll tax rate

As with benefit cuts, the size of the tax increases necessary to fix the system would vary depending upon when they become effective. **Charts 10.1-10.3** describe three different scenarios based on current projections wherein tax increases would generate sufficient revenues to pay all scheduled benefits over the next 75 years and to continue paying full benefits for a number of years at the end of that period. If implemented in 2010, an increase of 2.2 percentage points from 12.4 to 14.6 percent (employers plus employees) in the current Social Security tax rate would resolve the Social Security funding shortfall until about 2084.¹³ (**Chart 10.1**)

If the tax change is implemented in 2037 instead of immediately, the rate needed to continue paying benefits as scheduled through 2084 would be 16.5 percent – an increase of 4.1 percentage points, from today's rate of 12.4 percent. (**Chart 10.2**) By waiting until 2037, a larger increase is needed because it applies for fewer years. At the end of the 75 year period (in the absence of other program changes), meeting benefit costs in 2085 and several years thereafter would require taxes to be increased again to nearly 16.8 percent.

Chart 10.3 illustrates the pay-as-you-go tax rate that matches revenues to outlays while maintaining a Trust Fund ratio of 100 percent. It would begin to be implemented in 2032.¹⁴

These three scenarios show that delaying policy changes is equivalent to shifting a larger share of the financial burden of paying for scheduled Social Security benefits onto future taxpayers. This shift occurs because the later a tax rate increase is implemented, there are fewer future taxpayers within the 75 year budget window to pay the higher tax rate, thus the tax rate needs to be higher to meet the benefit obligations scheduled under current law. One way of equalizing the prospective financial burden across all of today's and tomorrow's taxpayers would be to immediately implement a tax rate increase that would provide sufficient revenue for the indefinite future. That would require a payroll tax rate estimated at 15.9 percent, (a 3.5 percentage point increase) to begin in 2010.¹⁵

Whether Congress decides to implement changes immediately or waits to implement tax rate and benefit changes in the future to achieve solvency, the choices do not alter the system's total deficit over the 75 year estimating period. As noted previously, earlier action would spread the adjustment costs over a larger population, but each person affected would bear a smaller adjustment cost. Postponing policy action to balance Social Security's taxes and benefits would concentrate adjustment costs on fewer future taxpayers, but each person would be affected more severely. Increasing Social Security tax rates in 2010 would allow the additional costs to be spread over many more generations – people born in the late 1940s who continue to work and earn today would pay more. On the other hand, postponing a Social Security tax increase until 2037 would mean that most of the people born before 1975, who would be at

¹³ The calculations for Charts 10.1-10.3 were based on the assumptions in the 2009 *Trustees Report*. Based on the 2010 Trustees assumptions the payroll tax rate would have to rise immediately to 14.24 percent to meet all scheduled benefits over the next 75 years, or to 14.38 percent to pay all benefits over 75 years and leave a balance in the Trust Fund equal to one additional year's benefit costs. The latter rate is slightly higher than the assumed actuarial deficit of 1.92 because the Trustees assume that as taxes increase there would be some slight measure of tax avoidance by employers and employees.

¹⁴ The pay-as-you go tax rate would begin to increase in 2032 because that is when the Trust Fund ratio is projected to fall below 100 percent on its way to exhaustion in 2037.

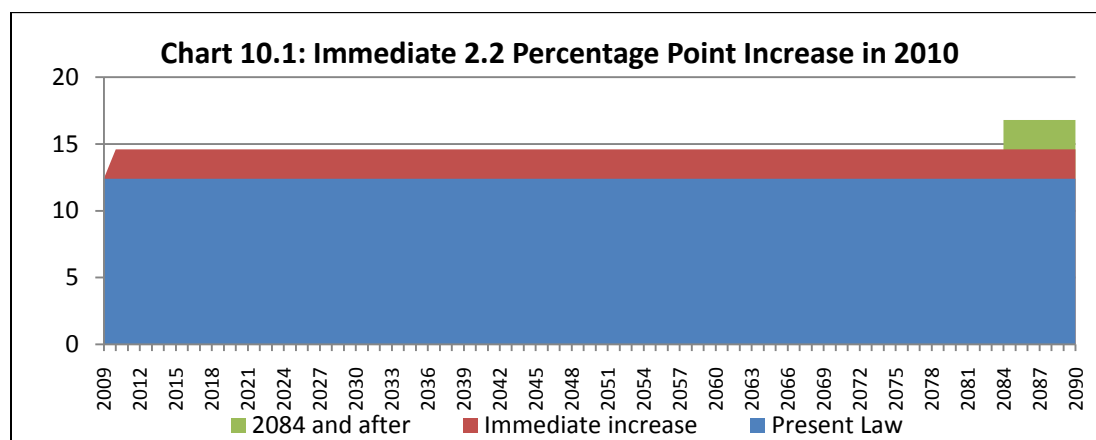
¹⁵ According to the Trustees: "[The] increase in the payroll tax rate is larger than the infinite horizon actuarial deficit of 3.3 percent of payroll due to the assumed response of employers and employees to an increase in taxes." That is, they assume that as taxes increase there would be some measure of tax avoidance, (See 2010 *Trustees Report*, page 61.)

or near age 62 in that year, would avoid paying any of the additional taxes necessary to pay full benefits to them in retirement. If reductions in scheduled benefits were enacted today for all future retirees, individuals born in 1948 (age 62 in 2010) and later would be affected. If the reductions were postponed until 2037, those born in 1975 (age 62 in 2037) and later would be affected more severely because those born during the time span of 1948-1974 would bear none of the burden of adjustment.

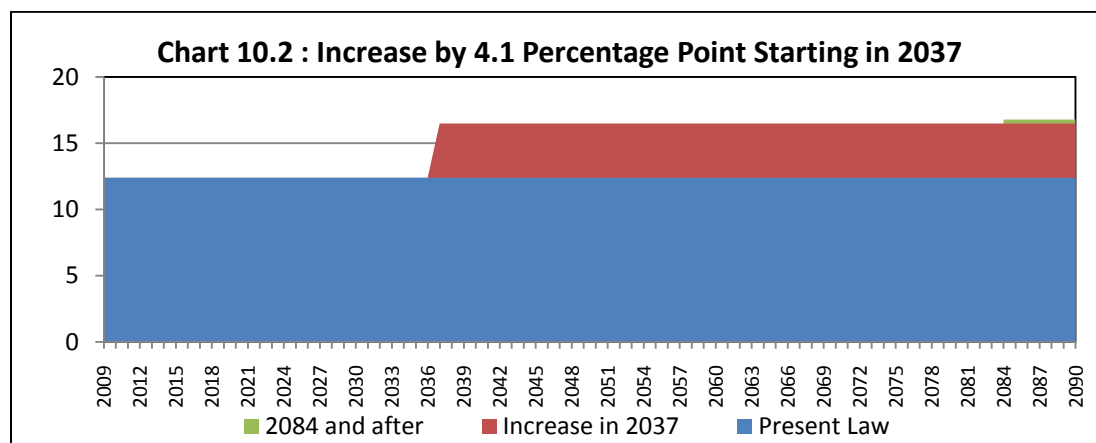
Social Security tax increases also reduce take-home pay for everyone who is required to pay them at the time they become effective. Because payroll taxes apply only to earnings below a certain annual limit (\$106,800 in 2010), tax increases place a heavier burden on those earning below the limit than those earning above this limit. The Social Security benefits they will eventually receive, by contrast, are designed to replace a higher share of pre-retirement earnings for lower income earners than for higher income earners. No additional retirement benefits are credited to workers on any of their earnings above the taxable maximum limit.

CHARTS 10.1-10.3: Payroll Tax Rates to Meet 75 year Deficit and Continue Paying Benefits after 2084

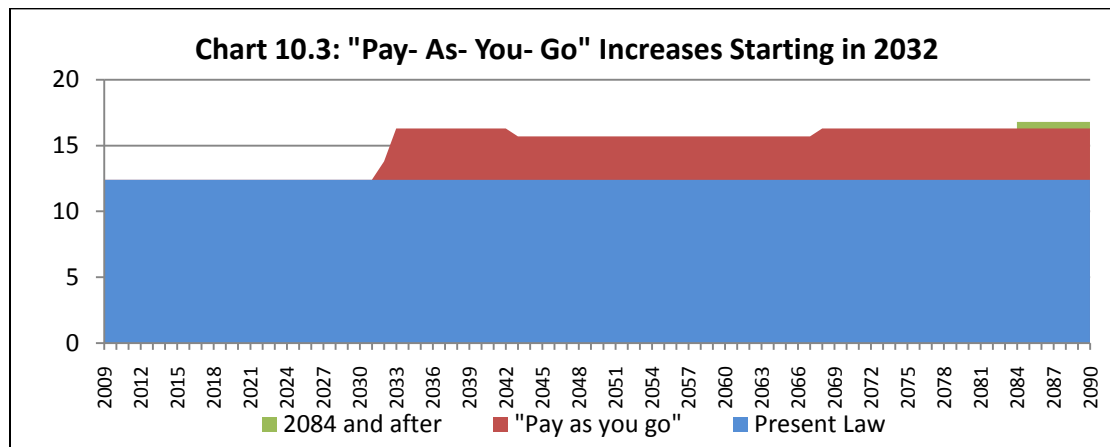
Scenario 1 assumes that payroll taxes are increased immediately, in 2010, by 2.2 percentage points to 14.6 percent. This would provide sufficient revenue to pay scheduled benefits until 2084 when the tax rate would have to rise by an additional 2.2 percentage points.



Scenario 2 assumes that no action is taken until the Trust Fund exhausts in 2037. At that point, payroll taxes would have to rise by 4.1 percentage points to 16.5 percent to meet scheduled benefits for the remainder of the 75 year period. In 2084 there would have to be a further increase to 16.8 percent.



Scenario 3 assumes that the current tax rate is maintained until the Trust Fund declines to about a one year reserve level (around 2032). Rates would then be increased on a pay-as-you-go basis sufficient to pay benefits and keep the Fund at a one year reserve: up to 13.8 in 2032, up to 16.3 percent from 2033 to 2042; down to 15.7 percent from 2043 to 2067, up to 16.3 percent from 2068 to 2083, and up to 16.8 percent in 2084 and for a few years after, and further increases thereafter.



As **Chart 11** illustrates in the case of the three payroll tax increase scenarios described above, earlier action (Scenario 1) could also build-up Trust Fund surpluses in an attempt to “pre-fund” future obligations. The economic impact of building up a Trust Fund surplus depends on whether it contributes to national savings and future economic growth or not. Trust Fund surpluses can contribute to national savings if the existence of the surpluses does not change government spending and tax rates. If Trust Fund surpluses cause government spending to be higher or non-Social Security taxes to be lower than they otherwise would have been, then those surpluses would not contribute to national savings.¹⁶ To the extent that higher national savings boosts economic and earnings growth, building up a Trust Fund that increases savings would help to ease the burden of financing the total 75 year deficit.

Research on the topic has supported both conclusions, with a larger body concluding that the Social Security Trust Funds have not increased national savings.¹⁷ And there is considerable skepticism that future Congresses would implement strict budget discipline if policy changes to restore Social Security to 75 year solvency generated larger Trust Fund surpluses.¹⁸

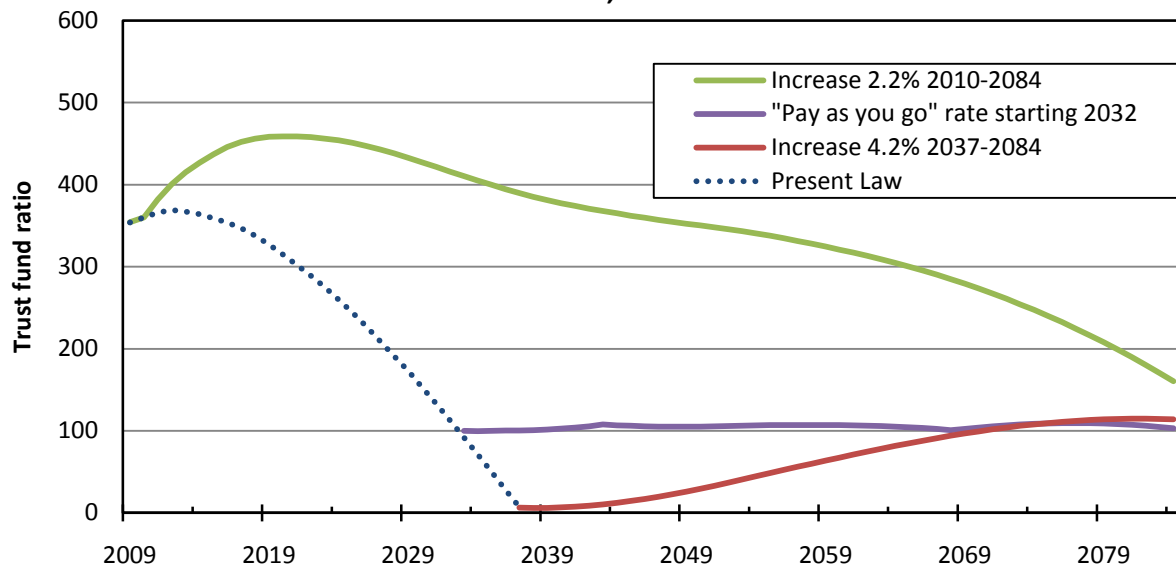
From a strict empirical standpoint, however, it is impossible to observe what government spending or taxes would have been in the absence of a particular surplus, and thus to say definitively how much higher or lower national savings would have been had the Trust Fund surpluses not existed. This presents a significant challenge to policy makers who essentially confront an even chance that future Trust Fund surpluses would be dissipated. If they are to implement reforms that significantly build up the Trust Funds, policy makers will have to devise a better system for saving the surpluses.

¹⁶ The buildup of Trust Fund surpluses can also affect private savings behavior. See Peter Diamond, “Social Security, the Government Budget and National Savings,” in *Samuelsonian Economics and the Twenty-First Century*, edited by Michael Szenberg, Lall Ramrattan and Aron A. Gottesman, Oxford University Press, 2006.

¹⁷ Nataraj, Sita; John B. Shoven (2004). *Has the Unified Budget Undermined the Federal Government Trust Funds?* National Bureau of Economic Research, Inc, NBER Working Papers: 10953. <http://www.nber.org/papers/10953>.; Samwick, Andrew A. (1999). "Social Security Reform in the United States." *National Tax Journal* LII (4); Feldstein, Martin S.; Jeffrey B. Liebman (2001). *Social Security*. National Bureau of Economic Research Working Paper 8451 (September).

¹⁸ For example see CBO long-term budget outlook for 2010 – the alternative baseline scenario, and 2010 Medicare Trustees Report.

Chart 11: Trust Fund Ratios for 3 Payroll Tax Increase Scenarios and Present Law , 2010-2084



Source: Social Security Administration's Office of the Chief Actuary calculations

IV. OPTIONS TO ADDRESS THE LONG-RANGE SOLVENCY PROBLEM AND THEIR IMPACT

To address the long-term financing shortfall in the Social Security program, policy makers really only have three choices: increase revenues, reduce scheduled benefits, or implement some combination of both. There are numerous ways to accomplish these objectives. Raising additional revenue, for example, could be accomplished by increasing payroll tax rates, expanding the tax base under existing rates, or devoting additional revenues from general revenues, among other options. Reducing program spending, for example, could be accomplished by reducing benefits for those with higher incomes, reducing annual cost of living adjustments for all beneficiaries, or increasing the full retirement age for future retirees, among other options. Numerous options are described below in some detail and summarized in **Appendix I**.

Legislative proposals to address Social Security's solvency usually include a variety of provisions. Some are composed almost exclusively of different ways to increase revenue, some exclusively to reduce benefits, while others include combinations of revenue increases and benefit cuts. The next section of this report describes several recent proposals that include such combinations as well as provisions that address multiple objectives, such as benefit adequacy and equity that are achieved by reducing particular revenues and increasing particular benefits. Readers should bear in mind that because different policy changes interact with each other, the financial effect of multiple policy changes implemented together is not necessarily the same as the sum of the effect of individual policy changes.

Which options are included?

This section describes ideas proposed by numerous lawmakers, organizations and policy experts to reduce the financial shortfall of Social Security by varying degrees over the next 75 years. Some options included in previous versions of this report but which are rarely discussed in policy circles today have been dropped. Several new ideas and approaches developed since the 2005 report have been added and are highlighted below. We emphasize that inclusion on this list of policy options is **not in any way an endorsement** by the Advisory Board for adopting any specific proposal.

This list of options is **not exhaustive**. It only includes provisions that have been scored by the Social Security Administration's Office of the Chief Actuary for the purpose of calculating their financial effects. Some are provisions that are included in larger proposals that are comprised of numerous changes, while others were submitted to the actuaries as a menu of individual options. Furthermore, some of the options included in this report were selected from what are often numerous variations of the same idea. Alternative specifications often vary the level of change, the date of implementation, the period in which changes are phased in, the duration they would last, or the populations to which they apply.¹⁹

Only provisions that improve the program's solvency are included here. Readers should be aware that there are many policy reforms designed to address other objectives: to improve the adequacy of benefits for some or all beneficiaries, to resolve perceived inequities in how the program impacts various groups, to provide incentives for working longer, or saving more. One exception is that we describe, in general, proposals to restructure the Social Security system by creating individual investment accounts that would supplement or replace part of the present Social Security system.

¹⁹ For other lists of policy options see the website of the Social Security Administration's Office of the Chief Actuary: <http://www.ssa.gov/OACT/solvency/provisions/index.html>; CBO, *Social Security Policy Options*, July 2010; Special Committee on Aging United States Senate, *Social Security Modernization: Options To Address Solvency and Benefit Adequacy*, May 13, 2010; and, Virginia P. Reno and Joni Lavery, *Fixing Social Security: Adequate Benefits, Adequate Financing*, National Academy of Social Insurance (2009).

Measuring the impact of policy changes

This section focuses, somewhat narrowly, on the financial impact of each policy option on the projected long-range gap between Social Security's revenues and expenditures. Specifically, we report estimates by the Social Security Administration's Office of the Chief Actuary of the impact each policy change would have on the cumulative 75 year deficit (known as the actuarial deficit)²⁰ and the size of that deficit in the 75th year of the projection. *All of the estimates described below are based on the 2009 intermediate assumptions of the Social Security Trustees and the projection methodology employed by the Social Security actuaries.*²¹ In 2009, the size of the 75 year (2009-2083) actuarial deficit was 2.0 percent of taxable payroll, a measure of all earnings subject to the OASDI payroll tax. The size of the deficit in the 75th year of the projection gives an indication of the on-going direction of the system's finances at the end of the projection horizon. In 2009, the deficit in 2083 was projected to be 4.34 percent of taxable payroll, considerably larger than the average over the 75 year period, indicating that the deficit will still be growing at that time.

Focusing only on the results of the projection under the intermediate or best guess assumptions can give the mistaken impression that the projected outcome is more certain than it is. The Chief Actuary's office does not publish such "range" calculations; however, its models could be used to inform policy makers of the chance that implementing a certain policy has of reaching its objective. For example, a given increase in the payroll tax rate may have a 50 percent chance of resolving the entire 75 year deficit, but a higher tax rate would be necessary to have 90 percent confidence of resolving the entire deficit.

Although they are beyond the scope of this report, there are other important ways to evaluate the impact of changes proposed to improve the long-range solvency of the program that policy makers can and should consider. Most important are the ways that various groups in the population would fare under alternative reforms. Policy makers should consider how each change impacts workers and retired or disabled beneficiaries in successive generations, at various ages, by gender, race, income, and marital status among other attributes. Even if the main objective of policy is to achieve long-term solvency, those policies will also impact the adequacy of benefits or the equitable treatment of workers and beneficiaries, and before action is taken, the full set of tradeoffs each choice requires should be understood.

Many different tools and measures have been developed to evaluate the budgetary and distributional consequences of Social Security policy alternatives and several recent reports have described some of those consequences for some policy alternatives.²² We believe wider use of these tools is appropriate and necessary and that their further development and refinement within government, academia, and the private sector should be encouraged. In this report, however, we mainly use two standard metrics – the change in the 75 year actuarial deficit and the 75th year's annual deficit – to describe the effects of alternative policy options.

Each of the policy options included in this report are scored and described in more detail on the website of the Social Security Administration's Office of the Chief Actuary. The letter and number combinations at the end of the description of each option below reference the equivalent solvency provisions on the Actuary's website. (See <http://www.ssa.gov/OACT/solvency/provisions/summary.html>.)

²⁰ The actuarial deficit is the sum of (a) the initial Trust Fund balance, (b) the present value over 75 years of the stream of revenues minus the stream of outlays, and (c) the cost in present value of holding in reserve one year's worth of benefits in the Trust Fund at the end of the period.

²¹ CBO also estimates the long-range financial impact of policy alternatives. Its projections are based on a somewhat different type of projection model and use economic assumptions that tend to be somewhat more optimistic than those used by the Trustees, but overall the results are similar.

²² For a discussion of the distributional consequences of specific reforms, see Jagadeesh Gokhale *Social Security: A Fresh Look at Policy Alternatives*, University of Chicago Press, 2010; CBO, *Social Security Policy Options*, July 2010; CRS, *Options to Address Social Security Solvency and Their Impact on Beneficiaries: Results from the Dynasim Microsimulation Model*, Report RL33840, January 29, 2007; Social Security Administration, Office of Retirement and Disability Policy, Policy Brief Series: *Distributional Effects of Raising the Social Security Payroll Tax* (April 2010); *Distributional Effects of Raising the Social Security Taxable Maximum*, (July 2009); *Distributional Effects of Reducing the Cost-of-Living Adjustments* (November 2008) and *Distributional Effects of Increasing the Benefit Computation Period* (August 2008).

Options That Reduce Scheduled Benefits

The formula for Social Security retirement benefits is based on a worker's career earnings. First, the worker's past earnings are indexed upward to account for past growth in average wages across the entire economy.²³ Second, the highest 35 years of indexed earnings are used to calculate the worker's averaged indexed monthly earnings or AIME. Third, the initial retirement benefit is calculated by adding together: 90 percent of AIME up to the (annually determined) first dollar threshold (\$761 in 2010); 32 percent of AIME between the first and second dollar threshold (\$4,586 in 2010) and 15 percent of AIME above the second dollar threshold until the (annually determined) taxable maximum. The dollar thresholds are called bend points and the final result is called the Primary Insurance Amount (PIA) which equals the initial retirement benefit if benefits are first claimed at full retirement age. (The worker's PIA also is used to calculate benefits for dependents or survivors.) The initial benefit amount is adjusted downward for those who claim retirement benefits before their full retirement age. Alternatively, benefits may be adjusted upward if the worker delays retirement by not claiming benefits until after reaching full retirement age. Individuals of any age who continue to work after they begin to receive benefits may have their monthly benefit amount recalculated if the additional year's earnings are higher than any annual amount previously included in their 35 year average. The dollar thresholds (bend points) are increased each year according to growth of average wages across the entire economy. Once an individual begins collecting benefits, the monthly amount may be increased each year to keep pace with inflation through an annual cost of living adjustment (COLA).

Options to reduce the shortfall in Social Security systems long-term financing can alter benefit formulae at any and all of the computation steps described above.

Options to increase the career earnings averaging period

At the present time, benefits are calculated based on a worker's highest 35 years of earnings up to a certain maximum. Adding additional years of lower earnings to the calculation will reduce future benefits for most workers. Lengthening the averaging period could serve as an incentive for workers to lengthen their working careers.²⁴ It is also fairer to those who start work at younger ages, for example, without college education, and who typically have longer working careers.

OPTION 1: Increase the career averaging period to 38 years

A gradual increase of the averaging period by three years, from 35 to 38, used to calculate retirement and survivor benefits (but not for disability benefits) would eliminate 15 percent of the 75 year actuarial deficit and 10 percent of the 75th year's deficit. [OACT B4.1²⁵]

OPTION 2: Increase the career averaging period to 40 years

A gradual increase in the averaging period by five years, from 35 to 40, used to calculate retirement and survivor benefits, (but not for disability benefits) would eliminate 23 percent of the 75 year actuarial deficit and 17 percent of the 2084 deficit. [OACT B4.2]

OPTION 3: Increase the career averaging period to 40 years and also apply to disabled worker benefits

²³ An individual's earnings up to two years before eligibility (currently age 60) are indexed to average wage growth to ensure that a worker's future benefits reflect the general rise in the standard of living that occurred during his or her working lifetime years with no earnings are entered into the average as 0s. After age 60 nominal earnings are used in the benefit formula without any indexation.

²⁴ Many workers experience higher than lifetime average earnings during the latter part of their careers. If those workers postpone retirement and benefit collection to offset the benefit reducing effects of this change, the system's solvency could be enhanced by more than is reported here because of additional payroll tax revenues.

²⁵ Each of the policy options included in this report are scored and described in more detail on the website of the Social Security Administration's Office of the Chief Actuary. The letter and number combination reference the equivalent solvency provision on the Actuary's website. See <http://www.ssa.gov/OACT/solvency/provisions/summary.html>.

A gradual increase in the averaging period by five years, from 35 to 40, used to calculate all benefits would reduce the 75 year actuarial deficit by 32 percent and the 75th year's shortfall by 24 percent. [OACT B4.3]

The effect on individual benefits of extending the career earnings averaging period beyond 35 years would depend on the worker's earnings history. For some workers with long careers and steady earnings, it would have no effect. For others, benefits could be reduced by up to 8 percent. On average, it would likely reduce benefits by about 3 percent. Workers with fewer years of earnings than average (including women who may have care-giving years outside of the paid workforce) would tend to have a larger reduction on their own earnings record.

Options to reduce initial scheduled benefits across-the-board

OPTION 4: Reduce initial benefits by 3 percent

An across-the-board benefit reduction of 3 percent for new beneficiaries starting in 2010 would eliminate 18 percent of the 75 year actuarial deficit and 12 percent of the 75th year's deficit. [OACT B6.1]

OPTION 5: Reduce initial benefits by 5 percent

An across-the-board benefit reduction of 5 percent for new beneficiaries starting in 2010 would eliminate 31 percent of the 75 year actuarial deficit and 19 percent of the deficit for 2084. [OACT B6.2]

Options to the change the rules for indexing initial benefits

Initial benefit levels for those reaching eligibility each year are automatically modified by a set of "wage-indexing" rules that have the effect of maintaining an approximately constant percentage replacement of career pre-retirement earnings. Such wage indexing incorporates higher wage levels, on average, thereby increasing AIMEs at the average rate of long-term wage growth. Allowing initial benefits to grow with average wages in the economy is intended to maintain a constant standard of living in retirement relative to one's working years.²⁶ These rules could be modified in any number of ways to provide smaller increases in initial benefit levels. Earnings for all workers could be indexed to a growth rate that is smaller than the growth of average wages, for example, somewhere between the growth rates of wages and prices. In addition, larger reductions could be made in the indexing growth rate applicable for higher earners than for lower earners.

OPTION 6: Indexing initial benefits to prices rather than wages

One alternative to the present system would be indexing initial Social Security benefits to price inflation rather than to wage growth. This would freeze the purchasing power of benefits at the level in effect at the time of the change and would result in a continual decline in the percentage of pre-retirement earnings that benefits replace. Price indexing would more than eliminate the present 75 year actuarial deficit, accumulating to 114 percent of that deficit, and would result in 65 percent more than the amount needed to close the shortfall in the 75th year. If this were the only reform enacted, it would result in an over-financed system. [OACT B1.1]

OPTION 7: Progressive price indexing

This is a hybrid approach. For individuals in the lowest part of the earnings distribution, benefits would be indexed according to wage growth as in the current law. For those at the highest earnings level, benefits would be indexed by the growth of prices. For those at intermediate earnings levels benefits would be indexed on a sliding scale between wage and price indexing. These approaches would affect the deficit by somewhat less than shifting to price indexing for all workers depending on how much progressivity is introduced. Maintaining current law wage indexing for all workers at the 30th percentile of lifetime earnings and below, price indexing earnings for the highest earners, and a sliding scale for those

²⁶ Prior to 1972, no automatic increases were provided so both replacement rates and the purchasing power of benefits would deteriorate over time, and the system would become over-financed as earnings levels increased until Congress would take action to raise benefit levels on an *ad hoc* basis.

in between would reduce the 75 year actuarial deficit by 66 percent and the 2084 shortfall by 91 percent if implemented beginning with those workers first eligible in 2016. [OACT B1.2]

The relative earnings threshold below which workers would be exempted from benefit reductions is changeable. Exempting workers with career average earnings below the 40th percentile from some measure of price indexing would reduce the 75 year actuarial deficit by 55 percent and the 75th year's shortfall by 76 percent. [OACT B1.3] Exempting workers with career average earnings below the 60th percentile from some measure of price indexing would reduce the 75 year actuarial deficit by 31 percent and the 75th year's shortfall by 36 percent. [OACT B1.5]

OPTION 8: Progressive reduction of initial benefits for top 70 percent of earners

Under this proposal the highest earners would have the largest benefit reductions while workers with lifetime earnings below some threshold would not be affected. Rather than anchor the reduction to changes in the indexing of workers' wages, the reduction in benefits for those with the highest earnings is held constant.

One such proposal would maintain current-law benefits for earners at the 30th percentile and below and reduce the upper two PIA formula factors (32 percent and 15 percent) such that workers with highest earnings (at the taxable maximum for 35 years) would have their benefit reduced by 1.1 percent per year as compared to current law benefits. Note that for some workers with intermediate earnings only the 32 percent bend point applies. Hence, the reduction of their benefits would be less than 1.1 percent per year. Disability benefits are not affected by the proposal. Disabled worker beneficiaries, upon attaining normal retirement age, would be subject to a proportional reduction in benefits based on the worker's years of disability. If the reduction is applied to individuals who become newly eligible for benefits in 2012 through 2061, the 75 year actuarial deficit would be reduced by 67 percent and the 75th year's deficit by 77 percent. [OACT B3.6]

OPTION 9: Index initial benefits to life expectancy

Reductions in scheduled benefits could also be implemented by altering the benefit formula according to improvements in life expectancy.²⁷ Indexing benefits to longevity for workers who become eligible for early retirement benefits at age 62 in 2019 (born in 1957) and younger would reduce the 75 year actuarial deficit by 28 percent and the 75th year's deficit by 44 percent. If life expectancy increased more rapidly than expected, scheduled benefits would be reduced at a faster pace. If life expectancy improved less rapidly than expected the reductions would occur more slowly. But this approach would automatically regulate total lifetime benefits of successive retiree generations in favor of maintaining the system's solvency. [OACT B2.1]

Options to gradually reduce initial scheduled benefits by reducing PIA factors

OPTION 10: Gradually reduce top two PIA formula factors for new beneficiaries

For each year from 2010-2040, multiply the 32 and 15 percent formula factors by 0.987, reducing the factors to 21 percent and 10 percent respectively, for those newly eligible for benefits in 2040 and later. This provision would reduce the 75 year actuarial deficit by 76 percent and the annual deficit in the 75th year by 68 percent. [OACT B3.1]

OPTION 11: Gradually reduce all three PIA factors

Gradually reducing all three benefit formula factors by 0.991 in each year 2013 through 2041 for beneficiaries newly eligible in 2013 and later would reduce the 75 year actuarial deficit by 73 percent and the 75th year's deficit by 72 percent. For workers first eligible (at age 62) for OASI benefits in 2041 and later the formula factors would be reduced by 23 percent to 69.2, 24.6 and 11.5 percent respectively. Upon conversion from disabled worker to retired worker benefits, benefit levels would be proportionally

²⁷ The PIA factors in the benefit formula would be multiplied by the ratio of life expectancy at 67 for 2014 to the life expectancy at age 67 for the fourth year prior to the year of benefit eligibility. Unisex life expectancies, based on period life tables, would be used as projected by the Social Security Administration's Office of the Chief Actuary.

reduced based on the fraction of years the individual was not disabled between ages 22 and 62. [OACT B3.4]

If the upper formula factor were reduced at a constant rate over the period of 2012 to 2049 and the lower and middle formula factors were reduced at a constant rate between 2017 to 2054 such that the formula factors fell from 90 percent to 67.6 percent, 32 percent to 16 percent, and 15 percent to 7.5 percent, it would eliminate the 75 year actuarial deficit, and more than all of the shortfall in the 75th year. [OACT B3.2]

Options to reduce the Social Security cost-of-living adjustment

Social Security benefits are protected against increases in the cost of living. Typically, all those currently receiving benefits will see their dollar benefit amount increase each year by the increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).²⁸ Some experts believe that the CPI-W overstates inflation, so some proposals would reduce the COLA by a set amount or base it on an inflation index that rises more slowly than CPI-W. Others believe that the CPI-W does not adequately measure the importance of certain goods and services that increasingly dominate the budgets of older Americans, such as health care costs and propose that COLAs should actually be increased.²⁹

OPTION 12: Reduce COLA by 1 percent

A reduction in the cost-of-living increase of 1 percentage point below the CPI beginning in 2010 would eliminate 78 percent of the average 75 year actuarial deficit and 50 percent of the 75th year's deficit. [OACT A1]

OPTION 13: Reduce COLA by 0.5 percent

A COLA reduction of 0.5 percentage point below CPI would eliminate 41 percent of the 75 year actuarial deficit and 26 percent of the 75th year's deficit. [OACT A2]

OPTION 14: Adopt "chained" CPI as basis for COLA

An alternative measure known as the "chained" CPI is based on the observation that rising prices lead consumers to substitute similar but cheaper goods and services in their purchases. Under the chained CPI measured annual price increases on which the COLA would be based would tend, on average, to be smaller by roughly 0.3 percentage points than under the current CPI-W. Basing the annual COLA on the "chained" CPI, would eliminate about 25 percent of the 75 year actuarial deficit and 16 percent of the 75th year's deficit. [OACT A3]

OPTION 15: Adopt "chained" CPI as basis for COLA, but do not apply to disabled worker benefits

The new COLA would apply to all OASI benefits. This would not apply to disabled workers who convert to retired workers at the full retirement age. This would eliminate about 18 percent of the 75 year actuarial deficit and 12 percent of the 75th year's shortfall. [OACT A4]

These changes in the COLA would reduce cost-of-living increases for all individuals who receive benefits after the changes are effective, including both current and future beneficiaries. Because the changes would be cumulative, their effect would grow over time. The impact would be greatest for those who receive benefits the longest: Long-lived retirees, and those who had been on disability at early ages. After 10 years, a reduction in the COLA of 1 percent per year would reduce benefits below those provided in current law by 10.5 percent, and after 20 years, by 22 percent. For a COLA reduction of 0.3 percent,

²⁸ There was no COLA in 2010 and 2011. See footnote 11.

²⁹ Rudolph Penner, *Adjusting Social Security Benefits for Changes in the Cost of Living*, Urban Institute, July 2010; CBO, *Using a Different Measure of Inflation for Indexing Federal Programs and the Tax Code*, February, 2010. The experimental Consumer Price Index for the Elderly has risen roughly 0.2 percentage points faster than the CPI-W. If implemented in 2012, basing the COLA on the CPI-E would increase the 75 year actuarial deficit by about 0.34 percent of taxable payroll according to recent estimates by the Social Security Administration's Office of the Chief Actuary based on assumptions in the 2010 *Trustees Report*.

after 10 years benefits would be 3 percent lower than currently provided, and after 20 years, 6.2 percent lower.

Options That Reduce Benefits By Increasing the Retirement Age

Under present law, full retirement benefits are payable if taken at or after the full retirement age (FRA), which is now scheduled to increase to age 67 for those born in 1960 (first eligible for benefits at age 62 in 2022). Benefits may now be taken as early as age 62, but are permanently reduced so that, on average, the same total lifetime benefits are payable regardless of whether benefits are taken at 62, at the FRA, or somewhere in between.³⁰ Increasing the full retirement age, therefore, has the effect of reducing the level of benefits. Future beneficiaries who claim benefits before FRA receive smaller benefits, and those who claim at FRA receive them for fewer months during retirement. Because life expectancy is increasing, the lifetime benefits payable for any given full retirement age will continue to increase, increasing the cost of the program.

OPTION 16: Speed up the scheduled increase in FRA to 67

Speeding up the scheduled increase in the full retirement age so that it is fully in effect for those who turn age 62 in 2010 (born in 1948 or later) would eliminate 4 percent of the 75 year actuarial deficit. It would have no impact on the annual deficit in the 75th year. The currently scheduled increase in the normal retirement age to 67 will lower the benefit payable at age 62 to 70 percent of the full retirement age benefit compared to an 80 percent reduction when full benefits were payable at age 65. [OACT C1.1]

OPTION 17: Speed up the increase to 67 and gradually increase the FRA to 68

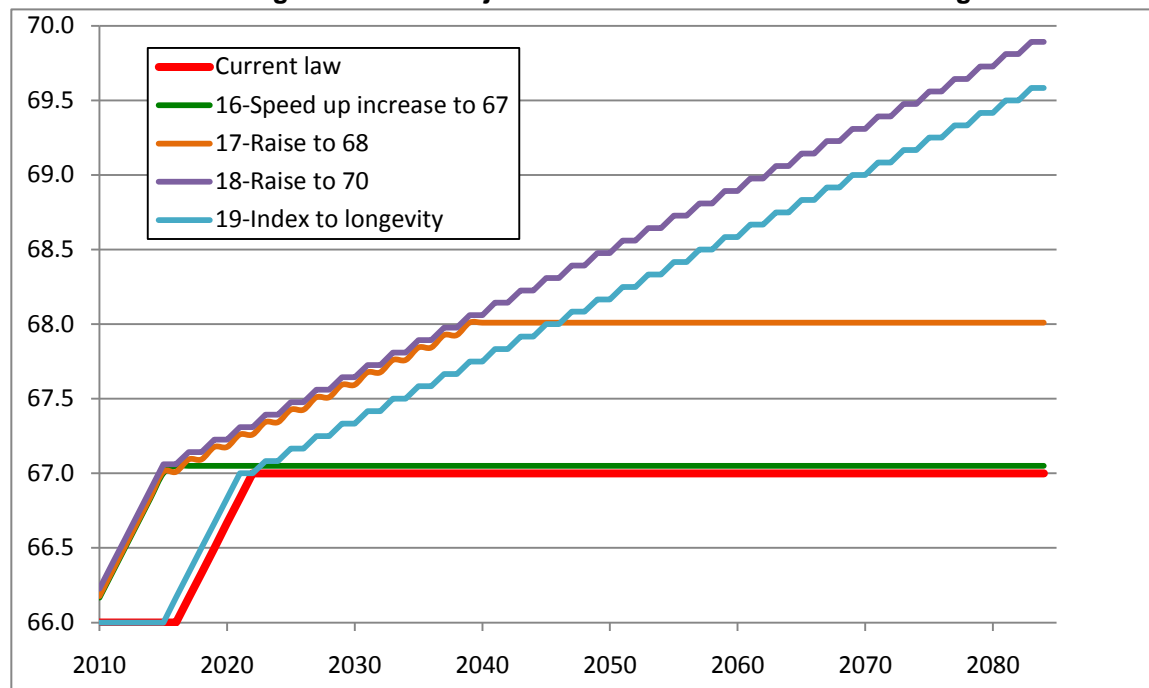
If in addition to speeding up the increase to age 67, the age was further increased to 68 at a rate of one month every two years, the 75 year actuarial deficit would be reduced by 23 percent, and the 75th year's annual shortfall would be 17 percent smaller. The full retirement age of 68 would be fully in effect for those reaching age 62 in 2039 (born in 1977). [OACT C1.2]

OPTION 18: Speed up the increase to 67 and gradually increase the FRA to 70

At a rate of one month every two years, increasing the full retirement age to 70 would be fully in effect for those reaching 62 in 2087 (born in 2025). This would eliminate 31 percent of the 75 year actuarial deficit and 33 percent of the 2084 shortfall. [OACT C1.3]

³⁰ Benefits are increased for each year that a worker delays claiming retirement benefits after the full retirement age up to age 70.

CHART 12: Illustrating Alternative Trajectories for the Normal Retirement Age



Source: Calculation by the Social Security Advisory Board based on memos from the Social Security Administration's Office of the Chief Actuary

OPTION 19: Index retirement ages to life expectancy

One way to offset the additional cost of paying benefits over longer life spans would be to gradually and automatically increase the full retirement age to keep pace with longevity increases. Speeding up the increase to age 67 by one year (to 2021), and indexing the full retirement age to longevity such that the ratio of expected retirement years to potential work years remains constant, would reduce the 75 year actuarial deficit by 21 percent, and the 75th year's deficit by 28 percent. Under the current assumptions of future improvements in life expectancy, this proposal would have roughly the same effect on the system's long-term financing as increasing the full retirement age by one month every two years. [OACT C1.6]

OPTION 20: Increase the earliest eligibility age (EEA) along with the FRA

As the full retirement age rises, one possibility to prevent a decline in benefit levels for early retirees would be to increase the earliest eligibility age along with increases in the full retirement age.

One proposal would begin in 2012 to increase both the EEA and FRA applied to retired worker benefits until the EEA reaches age 63 and the FRA reaches age 67 for those attaining age 62 in 2017. Both the EEA and FRA would then be indexed to maintain the then estimated ratio of life expectancy to potential working years (roughly a pace of one month every two years, under the Trustees current assumptions). This would reduce both the 75 year actuarial deficit and the 75th year's deficit by 28 percent. [OACT C2.2] By comparison, increasing only the early eligibility, but not the full retirement age would have almost no effect on future deficits because forcing a delay in benefit collection in this manner would be fully offset by an actuarially fair increase in benefits awarded. Indeed, this policy might increase the deficit very slightly as more workers apply for disability instead of early retirement after attaining age 62.³¹

Increasing the full retirement age and the initial eligibility age could induce workers to extend their careers or to accumulate additional resources to cover their income needs in the years prior to Social Security eligibility. It would also affect many employment-based pension plans that include early retirement incentives and pension offsets against Social Security benefits. Such a change would also

³¹ The exact amount of the impact would depend on what conforming changes were made to the benefit computation rules. [See <http://www.ssa.gov/OACT/solvency/provisions/summary.html> OACT solvency provision C2.1.]

affect individuals with disabilities who might have difficulty working at older ages. Some of the savings from increasing the full retirement age could be offset by expenditures resulting from increased disability benefits. To the extent that these changes would motivate more people to work longer than they otherwise would have, federal and state income tax revenue would also increase.

OPTION 21: Convert disability to retirement at the EEA

To limit the incentive to apply for disability benefits as retirement ages increase, one proposal would convert disabled beneficiaries to retired status upon attainment of their EEA (rather than their FRA) starting in 2012. The applicable early retirement reduction at EEA (currently 25 percent) would be phased in over 40 years for those converting from disability. Medicare eligibility for those who are still medically disabled would continue. After 2011, disability applications would not be accepted for those who would start benefits at ages higher than EEA. This would reduce the 75 year actuarial deficit by 18 percent and the 75th year's deficit by 17 percent. [OACT C2.3]

Options That Increase Revenue

Social Security benefits are primarily financed on a pay-as-you-go basis by payroll taxes on covered workers' earnings. Workers and employers each pay payroll taxes at a rate of 6.2 percent, while the self-employed pay full 12.4 percent on their labor earnings.³² Social Security payroll taxes are only collected on wages up to a maximum amount set by law and indexed each year to increase with the national average of all wages in the economy. For 2010, the taxable maximum level of earnings is \$106,800.³³ Approximately 85 percent of all earnings are covered by the payroll tax, and about 6 percent of all workers have wages that exceeds the maximum in a given year.³⁴ Social Security benefits are also subject to income taxes above certain income thresholds, and the proceeds from those taxes are credited to the Social Security Trust Funds. The options to increase Social Security's revenue include alternatives that enhance existing revenue streams – payroll taxes and income taxes on benefits – as well as proposals to add new revenue sources. As discussed in the next section, the addition of new revenue sources could even accommodate reductions of payroll tax rates.

Options to increase Social Security payroll tax rates

Increasing payroll tax rates would not affect those already retired and receiving benefits and would have a limited effect on those close to retirement. It would have the greatest effect on young workers and those not yet in the workforce who would pay increased taxes over most or all of their working lifetime. All employers of covered workers would also contribute. In all of the options described below, in order to sustain positive Trust Fund balances beyond the 75 year horizon, tax rates would have to be increased again slightly in the 76th year. By comparison, a tax rate increase of 3.3 percent of taxable payroll starting this year, would provide just enough revenue to pay scheduled benefits indefinitely but it would create very large balances in the Trust Fund during the next few decades.

OPTION 22: Increase payroll tax rates by 2.2 percent in 2010

³² In competitive labor markets employers would pass on almost the entire cost of payroll taxes to employees through lower wages, resulting in employees ultimately paying the full 12.4 percent payroll tax.

³³ The taxable maximum is not increased in years in which there is no COLA. The taxable maximum in 2010, therefore, was the same as in 2009.

³⁴ According to the 2010 *Trustees Report* (section V.C.3, page 116): "The portion of covered earnings that is taxable (i.e., at or below the base) was about 89.5, 86.8, and 82.8 percent for 1983, 1994, and 2000, respectively. This ratio of taxable earnings to covered earnings rose to about 85.8 for 2002, and then fell in subsequent years to reach 82.3 for 2007. The average annual rate of change in the ratio was about -0.4 percent between 1983 and 2007. Most of this decline was due to a relative increase in wages for high earners. The ratio rose to 83.5 percent for 2008 and further to 85.3 for 2009, largely due to a recession-induced reduction in the relative amount of wages of high earners. The taxable earnings ratio is projected to decline as the economy recovers, reaching levels for 2019 of 83.6, 82.8, and 82.1 percent for the low-cost, intermediate, and high-cost assumptions, respectively. After 2019, the taxable-to-covered earnings ratio is approximately constant."

An increase from the current 12.4 percent of taxable earnings (6.2 percent each for workers and their employers) to 14.6 percent in 2010 would eliminate the 75 year actuarial deficit and close 50 percent of the 75th year gap between income and outgo. [OACT E1.1]

OPTION 23: Increase payroll tax rates by 2 percent in 2022 and again in 2052

An increase in the tax rate of 2.0 percentage points to 14.4 percent in 2022 with an additional increase of 2.0 percentage points to 16.4 percent in 2052 would eliminate the 75 year actuarial deficit and close 90 percent of the 75th year's deficit. [OACT E1.2]

OPTION 24: Increase tax rates by 0.1 percent per year for 20 years

Gradually increasing the payroll tax rate by a total of 0.1 percent (employees and employers combined) per year for 20 years would result in a total rate of 14.4 percent by 2034. This provision would reduce the 75 year actuarial deficit by 70 percent and the deficit in the 75th year by 46 percent. [OACT E1.4]

OPTION 25: Return to pay-as-you-go financing with 100 percent Trust Fund ratio

If payroll tax rates were adjusted to maintain a balance in the Trust Fund just sufficient to pay 100 percent of expected benefits the following year (a Trust Fund ratio of 100 percent), those rates would increase to 13.8 in 2032, to 16.3 percent from 2033 to 2042; decrease to 15.7 percent from 2043 to 2067, and increase again to 16.3 percent from 2068 to 2083, and to 16.8 percent in 2084. By definition, these payroll tax rates would eliminate the 75 year actuarial deficit and the deficit in the 75th year.

Options to increase the cap on earnings subject to the Social Security tax

In 2010, earnings in employment covered by Social Security that exceed \$106,800 are neither subject to payroll tax nor considered for calculating benefits. This limit that determines the payroll tax and benefit base is increased each year by law to keep pace with increases in economy-wide average wages. Currently, about 85 percent of all covered earnings are below the taxable base, but this percentage has declined from about 90 percent in 1983. The share of workers with earnings over the cap has stayed steady at about 6 percent since 1983.

These provisions would raise additional revenues from higher-paid workers and their employers. Subjecting the top portion of earnings to higher marginal tax rates might induce behavioral responses such as reduced work hours and changes to the form of high earners compensation (e.g., from earnings to fringe benefits). How significant these behavioral responses would be in practice is open to debate.³⁵

OPTION 26: Eliminate the taxable maximum, but do not count additional earnings toward benefits

Making all earnings covered by Social Security subject to the payroll tax beginning in 2010, but retaining the current law limit for benefit computations (in effect removing the link between earnings and benefits at higher earnings levels), would eliminate 116 percent of the 75 year actuarial deficit and 57 percent of the deficit in the 75th year. [OACT E2.1]

OPTION 27: Eliminate the taxable maximum, and count additional earnings toward benefits

Eliminating the taxable maximum and counting all earnings toward benefit calculations would increase both revenue and benefits for the highest earning workers. It would reduce projected deficits by less than the previous option. If benefits were to be paid on the additional earnings, 95 percent of the 75 year actuarial deficit and 38 percent of the 2084 deficit would be eliminated. [OACT E2.2]

OPTION 28: Eliminate the taxable maximum, and count smaller fraction of additional earnings toward benefits

³⁵ See CRS Report RL33944, *Increasing the Social Security Payroll Tax Base: Options and Effects on Tax Burdens*, by Thomas L. Hungerford and Martin Sullivan; "Budget Magic and the Social Security Tax Cap," *Tax Notes*, March 14, 2005.

Currently earnings above a certain dollar threshold but below the taxable maximum are credited to benefits at a rate of 15 cents for each dollar in earnings. This proposal would create a new threshold at the current taxable maximum and credit only 3 percent of earnings above the threshold.³⁶ This provision would more than eliminate the 75 year actuarial deficit and eliminate 50 percent of the 75th year's deficit. [OACT E2.9]

OPTION 29: Increase the taxable maximum to include 90 percent of all covered earnings, but do not count additional earnings toward benefits

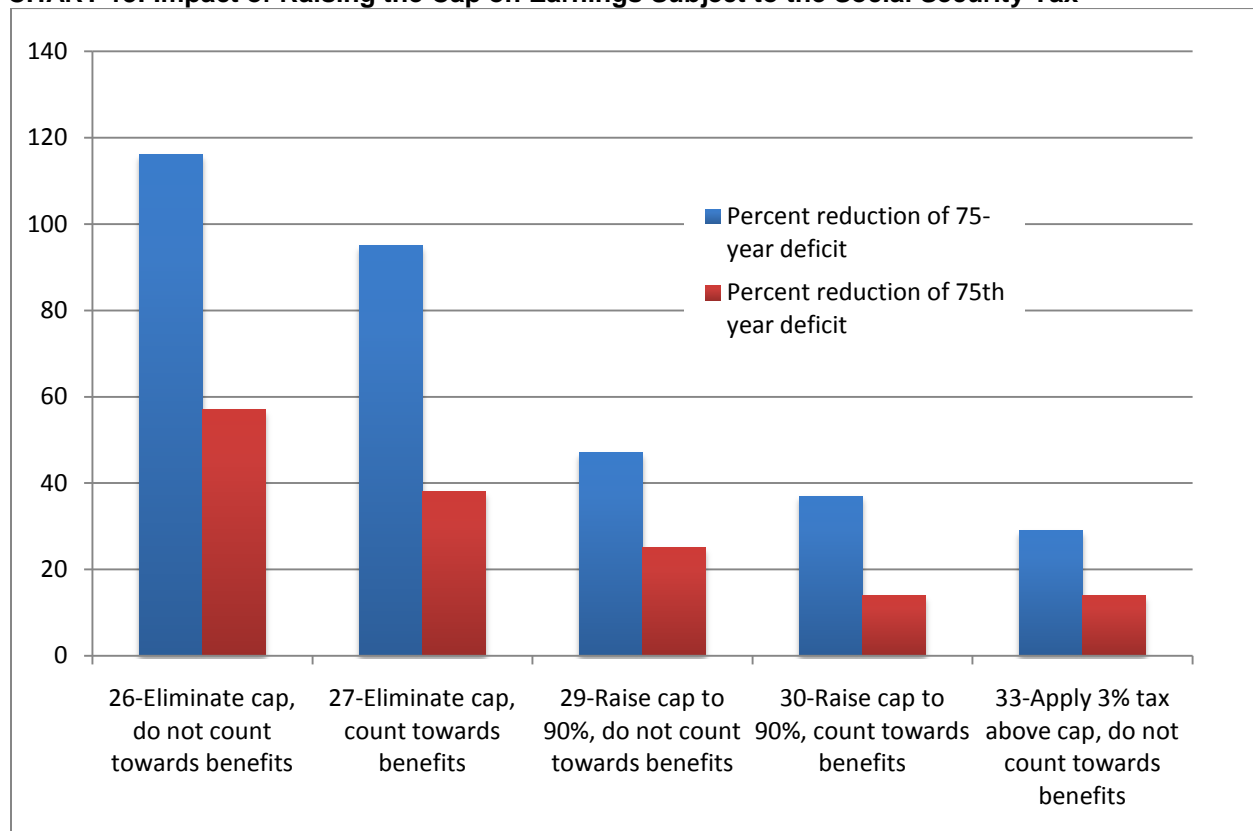
Phased in over 10 years, this would increase the estimated maximum amount of earnings subject to Social Security taxes in 2019 to \$315,000, compared to the projected level of \$150,900 under present law (in current dollars). Making 90 percent of total earnings covered by Social Security subject to the payroll tax but not paying benefits on the additional earnings, phased in from 2010 to 2019, would eliminate 47 percent of the 75 year actuarial deficit, and 25 percent of the deficit in the 75th year. [OACT E2.4]

OPTION 30: Increase the taxable maximum to include 90 percent of all covered earnings, and count additional earnings toward benefits

Setting the taxable maximum such that 90 percent of total earnings covered by Social Security are subject to the payroll tax and paying benefits on the additional earnings, phased in from 2010 to 2019, would eliminate 37 percent of the 75 year actuarial deficit, and 14 percent of the deficit in the 75th year. [OACT E2.3]

³⁶ All thresholds in the benefit formula increase when increases in the average wage index increases.

CHART 13: Impact of Raising the Cap on Earnings Subject to the Social Security Tax



OPTION 31: Eliminate cap for employers, raise to include 90 percent of earnings for employees and include additional earnings in benefit calculations

In this specification, the tax cap for employees would be increased by 2 percent over the current average wage index until 90 percent of covered earnings were under the cap. Employers would pay taxes on all earnings. This provision would eliminate 70 percent of the 75 year actuarial deficit, and 32 percent of the deficit in the 75th year. [OACT E2.11]

OPTION 32: Raise cap to apply to all earnings of 95 percent of covered workers

Since the taxable maximum was indexed to the average growth in wages, the share of the employed population with earnings below the cap in a given year has remained relatively stable at roughly 94 percent. Raising the taxable maximum from \$106,800 to \$115,200 (in 2009 average wage indexed dollars) over three years would mean the earnings of about 95 percent of covered workers would fall below the cap. Implementing further changes to the average wage index and crediting additional earnings for benefit calculation purposes reduce the 75 year actuarial deficit by 6 percent and the 75th year's deficit by 2 percent. [OACT E2.7]

OPTION 33: Apply an additional payroll tax on earnings above the current taxable maximum

Another option is to apply a payroll tax rate smaller than the current 12.4 percent rate to covered earnings above the current taxable maximum. Some proposals would apply the tax only to wages well in excess of the current maximum. Applying a payroll tax of 3 percent on earnings above the current taxable maximum starting in 2010 and not crediting those earnings to benefits would reduce the 75 year actuarial deficit by 29 percent and the 75th year's shortfall by 14 percent. [OACT E2.6] Increasing the levy to 6 percent on earnings above the current taxable maximum would reduce the 75 year actuarial deficit by 56 percent, and reduce the 75th year's shortfall by 28 percent. [OACT E2.8]

Options to extend Social Security coverage of employment or earnings

Social Security coverage is virtually universal, with the largest excluded group being employees of a number of state and local governments who are covered by their own pension system. About 25 percent of state and local government employees are not now covered by Social Security.

OPTION 34: Cover newly hired state and local government workers

A proposal to cover non-student state and local employees hired after January 1, 2010, would eliminate 9 percent of the 75 year actuarial deficit. Because the newly covered workers would ultimately qualify for benefits, the proposal adds slightly to deficits in the 75th year and beyond. The impact of this change would fall on those state and local governments whose employees are currently outside the Social Security system and on all individuals hired by these entities after the effective date of the change. [OACT F1]

OPTION 35: Subject employer provided group health benefits to OASDI payroll tax

The cost of employer provided group health – to employees and employers – is not subject to OASDI payroll taxes. Eliminating the deductibility of employees' costs and counting the employer costs as if it is part of an employee's wages for purposes of calculating taxes and benefits, would reduce the 75 year actuarial deficit by 57 percent and the 75th year's deficit by 22 percent. Both employees and employer taxes would be affected by this provision, and the size of the impact would depend in part of the growth in health care costs. Workers with more expensive health insurance plans would be impacted more than those with less expensive plans. [OACT F2]

Option to increase the portion of Social Security benefits subject to the income tax

OPTION 36: Tax Social Security benefits like private pensions

Under present law, Social Security benefits are taxable only if income is above specified thresholds. One alternative would be to phase out the thresholds and tax benefits in a manner similar to that for contributory private pension income. Phasing out the lower thresholds from 2010 to 2019, taxing benefits similar to private pensions, and putting all additional revenue raised into the Social Security Trust Funds would eliminate 14 percent of the 75 year actuarial deficit and 4 percent of the 75th year's deficit. Most beneficiaries would pay increased income taxes. However, because the income tax is structured to protect very low income people from paying taxes, beneficiaries with low income would still not pay any income tax on their benefits. [OACT H1] Phasing in the same changes over a 20 year period would have a very similar effect on Social Security's finances. [OACT H2]

Other Options

Options to invest Social Security reserves in marketable securities

Since the 1983 reforms, the Social Security Trust Funds have accumulated large positive balances currently held entirely in non-marketable special issue Treasury bonds. Some advocate maintaining significant reserves and investing a portion in marketable bonds or equities in order to achieve a higher long-term rate of return. Existing government pension plans, such as for employees of the Federal Reserve System, the Tennessee Valley Authority, and the U.S. railroads and many plans at state and local levels of government already do make direct investments in stocks. Because the Social Security Trust Funds are so large, (and potentially larger if other options are enacted), adopting this strategy would require that the government's role in managing investments in the stock market be addressed.

The financial impact of this proposal depends critically on methods of accounting for the riskiness of such investments. The Social Security actuaries evaluate the gains of investing in marketable securities using a variety of rates of return. In estimating proposals, the standard assumption is that the real interest rate on long-term Treasury bonds is about 2.9 percent and that investment in stocks would yield a 6.4 percent real rate of return, slightly below the average over the 20th century of 7 percent (equivalent to an "equity premium" of 3.5 percent). They also estimate the accumulation of assets based on a rate of return of 2.5 percent above the Treasury bond rate.

Many financial economists believe the proper way to account for these assets, however, is to recognize that higher returns are only available at the cost of higher risk. Trust Fund assets correspond to liabilities on the general government's account and those liabilities are properly valued on a risk-adjusted basis. On a risk adjusted basis, future expected returns from investing in equities should be valued the same as investing in risk free Treasury bonds. There would be no impact on the long-term deficit. In other words, investment in higher return/higher risk securities does not provide a "free lunch."

Another way of explaining this is if the value of Trust Fund equities was eroded significantly because of a future capital market collapse, the financial cost of continuing benefit payments as scheduled may have to be borne by workers' through higher payroll taxes. Under equity investments by the Trust Fund, the cost of that risk to future taxpayers is increased compared to continuing Trust Fund investments in Treasury securities. The increased taxpayer risk is paid for in terms of the risk premium earned on the Trust Fund's equities. But that risk premium should be credited toward counteracting the increased risk to future taxpayers and not, as some believe, toward a net improvement in the program's long-term financial condition.

The scoring of these types of reforms by Social Security's actuaries (as listed below) suggest that they would reduce Social Security's 75 year actuarial deficit and future annual deficits. However, for the reasons discussed earlier – such scoring incorporates an unwarranted "free lunch" into the estimated improvement in those two Trust Fund solvency metrics.

OPTION 37: Invest 40 percent of Trust Fund in equities

If in the future the return on stocks were 3.5 percentage points higher than the rate of return for Treasury bonds, then a 40 percent investment in stocks phased in between 2010 and 2024 would eliminate 34 percent of the 75 year deficit. [OACT G1] If the return on stocks averages 2.5 percentage points higher than for bonds, then a 40 percent investment in stocks would eliminate 24 percent of the 75 year deficit. [OACT G2] Because the proposal does not fully eliminate the deficit under either assumption, it would, by itself, have no impact on the deficit in the 75th year (by which time the Trust Funds would have been exhausted). On a risk-adjusted basis, such investments would be valued at the same rate as investment in Treasury bonds and would therefore have no expected impact on the long-term deficit. [OACT G3]

OPTION 38: Invest 15 percent of Trust Fund in equities

Under this proposal, Trust Fund assets would gradually (1.5 percent per year for 10 years) be invested in a broad index of equity market securities (such as the Wilshire 5000). Assuming a real rate of return of 6.4 percent would reduce the 75 year deficit by 14 percent. Because the proposal does not fully eliminate the deficit under either assumption, it would, by itself, have no impact on the deficit in the 75th year (by which time the Trust Funds would have been exhausted). [OACT G4] On a risk-adjusted basis, such investments would be valued at the same rate as investment in Treasury bonds and would therefore have no expected impact on the long-term deficit. [OACT G5]

Options to create individual investment accounts

Social Security was designed and continues to operate as a defined benefit social insurance program. Monthly benefits are paid using a formula based on each worker's lifetime earnings. The system is financed largely on a pay-as-you-go basis: today's beneficiaries are paid benefits financed directly out of today's payroll taxes levied on today's workers and income taxes levied on the benefits of high-income Social Security beneficiaries, (and from assets in the Trust Funds when tax revenues fall below benefit obligations and the Trust Fund balance is positive). Some reform plans propose to re-structure the program so that it resembles a defined contribution plan. In a defined contribution plan, benefits are paid based solely on each worker's contributions and accumulated earnings from investing those contributions. Defined contribution plans are savings programs, so the benefits can be said to be pre-funded.

There are two distinct forms of individual account plans that are distinguished by how they are funded. In the context of this report, it is important to note that neither type of plan would directly affect the

long-term shortfalls in Social Security finances.³⁷ So-called “carve-out” accounts redirect a portion of each worker’s current payroll taxes into an individual account. So-called “add-on” accounts would contribute funds from general revenues and/or require additional contributions from workers on top of current payroll taxes. Reform proposals include voluntary or mandatory participation and some proposals would allow additional contributions by workers. Estimating expected gains from either form of individual account should be on a risk-adjusted basis as described in the section on investing Trust Fund balances in marketable securities.

OPTION 39: Carve-out individual investment accounts

Some amount of current payroll taxes would be re-directed to an individual’s account where accumulated balances could be invested at the direction of the worker. Future benefits are paid from accumulated account balances and reduced traditional Social Security benefits. Because Social Security must continue to pay benefits to individuals who have already contributed to the current pay-as-you-go system, any transfer of payroll taxes from the Social Security Trust Funds into individual accounts would have to be offset from increases in other taxes, reductions in other government expenditures, or increased government borrowing from the public. These offsetting financial arrangements are sometimes referred to as “transition costs.”

OPTION 40: Add-on individual investment accounts

The current defined benefit system would remain as it is. Individual accounts would be funded by contributions from general revenues and/or from additional payroll taxes imposed on top of the current payroll taxes used to pay current beneficiaries. These proposals would not directly impact any revenues dedicated to the traditional system, and benefits from accumulated balances would be entirely in addition to traditional Social Security benefits.

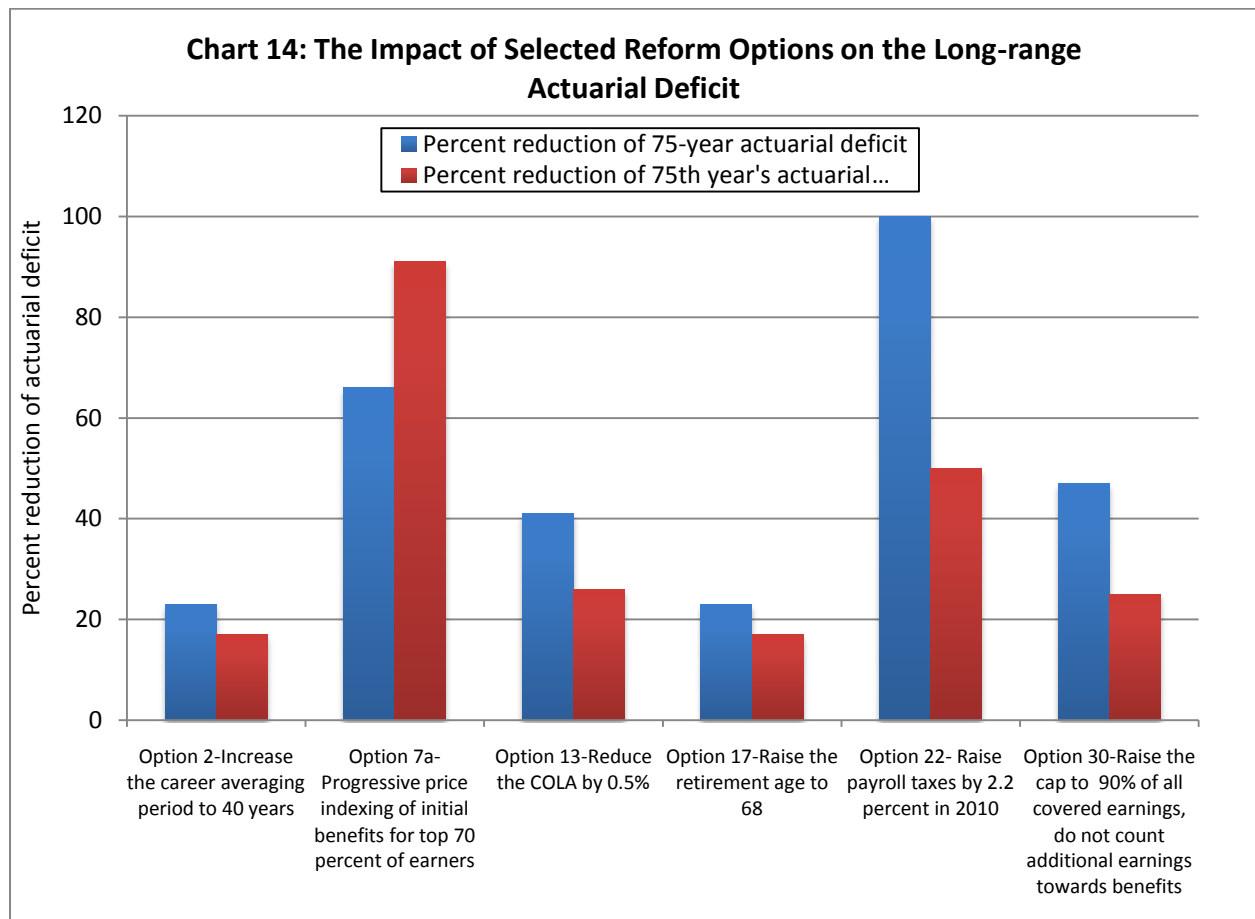
Proponents of creating individual accounts believe it would provide risk diversification in retirement resources, increase private ownership of retirement assets, and enable individuals to control how their retirement funds are invested. Because balances would tend to increase the longer they are allowed to accumulate and the longer contributions are made, a defined contribution system may provide stronger incentives for longer working lives. During times of net accumulations in individual accounts (net of withdrawals for personal consumption), individual accounts would provide a mechanism to prevent surplus funds from being spent in the regular federal budget process, rather than saved. The flow of funds into individual accounts increases national savings and investment, increasing capital per worker which in turn increases labor productivity and ultimately expands the payroll tax base. Proponents of individual accounts also believe that the retirement system should be pre-funded by savings and not redistribute income within and across generations as under the traditional Social Security system.

Those who oppose creating (primarily “carve-out”) individual accounts maintain that the essential defined benefit social insurance character of Social Security works well and suits the needs of the American people. They oppose placing the additional burden of investment risk on individuals, especially as the private employer pension system is increasingly dominated by defined contribution plans. Opponents also believe that managing individual accounts will make more people vulnerable to fraud or mismanagement or poor decision-making. Protecting people from those risks would add to the administrative expense of an investment-based retirement system. Some maintain that the transition costs of a “carve-out” plan would be too high. Opponents also believe that individual accounts would disproportionately favor higher income investors.

Under an individual account system retirement resources would be exposed to additional market uncertainty, but it is not clear whether the total degree of uncertainty would increase or decrease upon shifting toward a defined contribution-type of Social Security system. That is because the need to resolve the current system’s outstanding financial imbalance through policy changes introduces “policy” uncertainty that may be no smaller than the market uncertainty facing Social Security individual account participants.

³⁷ Although establishing individual investment accounts does not address the systems solvency, past versions of this report have included a discussion of these proposals because of the prominence they have played in public policy debates over the past decade.

Chart 14 compares the impact on long-term solvency of several commonly discussed reform options.



V. Issues Raised by Proposals to Address the Long-Range Solvency Problem

Over the 75 years that Social Security has been in place, many changes have been made to this important program. But it has remained grounded in the principles of social insurance; that is, that benefits should be adequate and equitable. Proposals to address long-range solvency should ensure continued protection from the “hazards and vicissitudes of life.”³⁸ Benefits should be generous enough to provide a foundation for economic security and should be equitable relative to the level of contributions made. The challenge for policy makers will be striking a balance between adequacy and equity.

Many among policy makers and the public appreciate that Social Security is one leg of the “three-legged stool” for providing workers with undiminished living standards during retirement and ensuring economic support to dependents, survivors, and people with disabilities. However, savings contributed by the other two legs (private defined benefit pension plans and personal savings) appear inadequate for ensuring that those objectives could be met in the future. In this context, the projected insolvency of Social Security compounds the risk of inadequate living standards for future generations of retirees and other beneficiaries. The longer that Social Security reforms to restore the program’s financial solvency are delayed, the larger the risk not only of reduced retirement living standards but also of policy makers’ inability to strike the desired balance between the equity and adequacy of Social Security benefits. The questions that follow highlight the issues that are likely to be raised in the ongoing discussion around the future of Social Security.

Will benefits be adequate?

- Do the benefits, combined with private savings and employer pensions, provide adequate retirement income protection for workers and their families?
- Is there adequate benefit protection for workers who become disabled?
- What benefits are provided for dependents and survivors when a worker retires, dies, or becomes disabled?
- Are beneficiaries adequately protected against inflation?
- Will there be more or fewer people living in poverty?

Will costs and benefits be fair?

- Are individuals in equal circumstances treated equally?
- Are particular groups, like working spouses (especially women) and workers who engage in arduous labor, adversely affected?
- Will lower wage workers receive proportionally higher benefits relative to their contributions than higher wage workers?
- How will the burden of program changes be shared by current and future workers and beneficiaries?

³⁸ *What is Social Insurance?* Volume IX, Committee Publications, Committee on Economic Security, 1933.

How do the changes affect an individual's behavior?

- Does the benefit and tax structure encourage work effort or participation in the labor force?
- Are there sufficient incentives to encourage increased individual savings?
- Does the proposed change promote flexibility in life-cycle choices such as acquiring more education or deciding when to retire?

How will the economy be affected?

- What will happen to national savings? Will we save more or less than we do now?
- What will happen to economic growth? Will the economy grow faster or slower than it does now?

What is the effect on the financial obligations of the federal government?

- Does the proposal contribute to a budget surplus or a budget deficit?
- What is the impact on total obligations?
- What is the impact on Medicare?

What will be the effect on program efficiency and integrity?

- How will the proposal affect administrative efficiency?
- How will it affect the accuracy of benefit payments?

What will be the effect on public confidence, understanding, and acceptance?

- Will the proposal enhance or diminish public confidence in Social Security?
- How will the changes affect public understanding of the program?
- Are the changes consistent with maintaining broad public acceptance of the program?

V. Examples of Plans to Restore Social Security Solvency

In practice, concrete proposals to address the shortfalls in Social Security's long-term finances are not limited to single policy options, but combine several types of changes. Although achieving solvency is usually the primary goal, many reform proposals also try to address other goals such as benefit adequacy and equity, and are mindful of the incentives implicit in certain types of changes. For example, the previous section of this report did not describe any provisions that would increase benefits or reduce revenues, because by themselves they would not improve Social Security's solvency. But as part of larger packages that do achieve solvency, these types of provisions may help address adequacy or equity concerns.

Below we describe several examples of integrated proposals as an illustration of how policy alternatives might be fashioned into comprehensive reform packages. We have grouped them into three categories. First, we describe examples of how various provisions can be combined to achieve solvency and other objectives. Second, we describe examples of specific legislative proposals from across the political spectrum, including two that have been submitted as legislation in the 111th Congress (2010). Third, we include the proposals of two very recent commissions that recommended ways to accomplish Social Security solvency alongside a much larger set of recommendations for reducing the national debt over the long-term.³⁹ Inclusion in this list is not in any way an endorsement by the Advisory Board of any particular plan.

All the plans described below have been submitted to the Social Security Administration's Office of the Chief Actuary for the purposes of estimating their effects on Social Security finances. Because the plans were submitted in various years, however, the Actuary's financial estimates were made under slightly different assumptions. For that reason we do not compare the financial impact of the various plans. In addition, the reader should be aware that the impact of several options integrated into one package is not necessarily the same as adding up the impact of the individual constituent provisions. The reason is that various provisions can interact, partially offsetting or magnifying the impact of other provisions. The net effect of an integrated proposal could be greater or less than the sum of the constituent elements.⁴⁰

The plan descriptions below are meant to illustrate how proposals combine the various options and other alternatives described in Section IV of this report. In order for the policy makers and the general public to adequately compare the likely outcomes of each plan, however, they need to be evaluated across a variety of dimensions using a common set of widely agreed upon metrics. Proposals can be evaluated not only by their impact on the summarized 75 year actuarial balance, but also, for example, by their impact on annual revenue and benefit flows, the Unified Budget, and the incomes of workers and beneficiaries, over time and across various socio-demographic characteristics and generations. Recommending a broad set of evaluation metrics is beyond the scope of this report, but as we emphasized in Section IV they must continue to be developed and refined within government, academia, and the private sector.⁴¹

³⁹ In both cases, the commissions stated that restoring long-term solvency to Social Security was important in its own right independent of need to address the United States' long-term fiscal debt.

⁴⁰ For a more detailed explanation of potential interactions see the Social Security Administration's Office of the Chief Actuary's website page entitled, "Understanding Interaction among Individual Provisions that Would Change the Social Security Program," <http://www.ssa.gov/OACT/solvency/provisions/interaction.html>.

⁴¹ For an example of one author's recent development of metrics that would facilitate the evaluation of alternative reform packages see Jagadeesh Gokhale, *Social Security: A Fresh Look at Policy Alternatives*, University of Chicago Press, 2010. Some observers have also proposed that in addition to a Trust Fund perspective, proposals should be evaluated on a more comprehensive federal budget perspective.

Examples of ways to combine options to address solvency

Reno & Lavery (2009)

In their 2009 report, *Fixing Social Security: Adequate Benefits, Adequate Financing*, Virginia Reno and Joni Lavery, of the National Academy of Social Insurance (NASI), describe many options that address both the adequacy of Social Security benefits and the program's long-term solvency. In the report they provide one example of how various options could be combined to address both goals (see Box 1, page 7 of their report). The package they describe should be understood as an illustration of how a proposal could be put together. It is not a formal proposal on behalf of NASI or an endorsement of any proposal by the authors and NASI. Many variations of their package are possible. It should be noted that their specific example contains multiple provisions that increase benefits and thus was not discussed in the previous section of this report.

Provisions to achieve solvency. The package would increase revenue in several different ways and reduce one type of benefit. In descending order of their impact on finances: (1) The payroll tax rate would be increased by 1/20th of 1 percent per year (for employees and employers) for 20 years beginning in 2015 and ending in 2034. (2) The taxable maximum would be raised gradually (over 36 years) to include 90 percent of all covered earnings. (3) Revenues from the estate tax, at 2009 levels, would be dedicated to Social Security to provide a progressive source of tax revenue to cover the system's "legacy costs."⁴² (4) For the purposes of payroll taxation, salary reduction plans such as flexible spending accounts for dependent care, health care or qualified commuting costs would be treated like contributions to 401(k) plans; that is, they would be deductible from income taxes but counted as part of wages for the purpose of payroll taxes. (5) The spousal benefit would be reduced from 50 percent to 33 percent at a rate of 1 percent per year over 17 years.

Provisions to improve benefit adequacy. In descending order of their cost, the provisions to improve benefit adequacy are: (1) Increase benefits by 2 percent for all those eligible for benefits as of 2010 and for anyone becoming eligible after 2010. (2) Increase the special minimum benefit to pay 125 percent of poverty for anyone who worked under Social Security at least 30 years and claimed benefits at full retirement age. Up to eight years in which a parent had a child under age 5, could count as a year of coverage. (3) Continue benefits for children of disabled or deceased workers until age 22 if the child is in high school, college, or vocational school. (4) Pay a new capped benefit to widowed spouses equal to 75 percent of the sum of worker benefits received by the two spouses if such a benefit would be higher than payable under current law.

National Research Council/National Academy of Public Administration (NRC/NAPA) (2010)

The National Research Council and the National Academy of Public Administration Committee on "Choosing the Nation's Fiscal Future" produced alternative ways to achieve sustainable solvency for Social Security. The packages differ in the shares of overall changes that would come from tax revenues or benefit reductions. Proposal 1 would eliminate the Social Security long-term deficit solely through reduction in the growth of benefits. Proposal 2 would be composed of 2/3s benefit reductions and 1/3 revenue increases. Proposal 3 would be composed of 1/3 benefit reductions and 2/3s revenue increases. Proposal 4 would eliminate the deficit entirely through increasing revenue.

Proposal 1. (1) Progressively index the PIA formula factors from 2012 through 2049 such that those with lifetime average earnings at the 30th percentile and below would be unaffected, but for the remaining 70 percent, the top two PIA factors (32 and 15) would be reduced so that a steady maximum earner's benefit would be reduced each year that progressive indexing applies by 1.1 percent. Disability benefits are unaffected. (2) Accelerate the scheduled increase in the full retirement age to 67 by five years, and then index it to maintain the ratio of expected average retirement years to potential work years, roughly

⁴² According to Reno and Lavery: "The decision to pay benefits to retirees in the early years that far exceeded the value of the contributions that they and their employers had had time to make created a deficit of contributions or 'legacy costs' that future generations would have to face.... In essence, Social Security costs can be divided into two parts – the funds necessary to pay for current benefits and the funds required to cover legacy costs. While workers' and employers' contributions from wages are designed to cover the first type of costs, more progressive taxes on a broader tax base could be justified to cover 'legacy costs' that were incurred to provide for the common good in the early years." (See page 20.)

equivalent to an increase of one month every two years. Raise the earliest eligibility age along with the NRA starting in 2012. Relax the vocational standards for disability for those ages 60 and over.

(3) Compute cost of living adjustments (COLAs) using a “chained” version of the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), a reduction of approximately 0.3 percent per year compared to the existing COLA. Disability benefits are not affected until conversion to retired worker status.

Proposal 2. (1) Progressively index the PIA formula factors from 2012 through 2061 such that those with lifetime average earnings at the 30th percentile and below would be unaffected, but for the remaining 70 percent, the top two PIA factors (32 and 15) would be reduced so that a steady maximum earner's benefit would be reduced each year that progressive indexing applies by 1.1 percent. (2) Raise the payroll tax (currently 12.4 percent) to 12.6 percent in 2012, 12.9 percent in 2020, 13.1 percent in 2030, 13.9 percent in 2040, 13.5 percent in 2050, and 13.3 percent in 2060.

Proposal 3. (1) Progressively index the PIA formula factors from 2012 through 2021 such that those with lifetime average earnings at the 30th percentile and below would be unaffected, but for the remaining 70 percent, the top two PIA factors (32 and 15) would be reduced so that a steady maximum earner's benefit would be reduced each year that progressive indexing applies by 1.1 percent. (2) Raise the payroll tax rate (currently 12.4 percent) to 12.6 percent in 2012, 12.9 percent in 2020, 13.3 percent in 2030, 13.8 percent in 2040, 14.4 percent in 2060, and 14.5 percent in 2075. (3) Apply a payroll tax rate on earnings above the taxable maximum with no credit toward benefits, of 2 percent starting in 2012 and 3 percent starting in 2060.

Proposal 4. (1) Increase the taxable maximum (contribution and benefit base) by an additional 2 percent over normal indexing starting in 2012, until 90 percent of OASDI covered earnings are taxable (achieved in 2048). The present-law taxable maximum is retained for benefit purposes; no benefit credit is given for earnings above the present-law taxable maximum. (2) Increase the payroll tax rate (currently 12.4 percent) to 12.7 percent in 2012, 13.0 percent in 2025, 13.3 percent in 2040, 14.0 percent in 2060, 14.5 percent in 2070, and 14.7 percent in 2080. (3) Apply a payroll tax rate on earnings above the taxable maximum with no credit toward benefits of 2.0 percent starting in 2012, 3.0 percent starting in 2025, 3.5 percent starting in 2040, 4.5 percent starting in 2050, and 5.5 percent starting in 2060.

Examples of standalone Social Security reform proposals

“A Reform Proposal to Make Social Security Financially Sound, Fairer, and More Progressive” (2008)

Mark Warshawsky, former Assistant Treasury Secretary for Economic Policy and current member of the Social Security Advisory Board, developed “A Reform Proposal to Make Social Security Financially Sound, Fairer, and More Progressive” in 2008. The package contains a number of provisions to address solvency, equity, and rewards and incentives for longer working lives. The plan aims to return the system to a pay-as-you-go financing basis, and provides add-on individual investment accounts for lower income workers. It includes provisions that both increase and decrease revenues and makes various reforms to private pensions.

Provisions that affect revenues. (1) Immediately and permanently reduce the payroll tax rate from 12.4 percent to 11.4 percent. (2) Exempt workers (and their employers) who have 40 years (or 180 “quarters”) of covered earnings from any future payroll taxes. Future earnings would not be credited for benefit calculations. (3) To make the system more progressive, raise the taxable maximum over 10 years so that 95 percent of all workers would have earnings entirely below the cap, and credit the additional earnings for computation of benefits. (4) Tax Social Security benefits in a manner similar to private pension income and credit the increased revenues to the Trust Funds. (4) Broaden the tax base by covering all new state and local workers.

Provisions that affect benefits. (1) Increase the averaging period for career earnings from 35 years to 40 years, phased in over 10 years. (2) To slow increases in benefits while still allowing a slight increase in the real value of benefits, reduce all three PIA formula factors (90, 32, and 15) by .9 percent per year between 2012 until 2041. (3) Accelerate by five years the scheduled increase in the full retirement age to 67 and subsequently index the retirement age to hold constant the ratio of expected lifetime in retirement

to the length working careers (a rate of about one month every two years). Apply the rate of change to the earliest eligibility age (now 62) as well as to the maximum claiming age (now 70), and the eligibility age for aged and disabled widow benefits. (4) To discourage unwarranted applications for disability as the retirement age increases, disability benefits would be converted (on a prorated basis) to retirement benefits at the earliest eligibility age instead of the full retirement age.

To help make up for the reduction in scheduled benefits for low wage and disabled workers, and to increase national savings, the plan would establish add-on individual investment accounts. Participation would be voluntary with a default automatic enrollment (with an opt-out provision) for all low and moderate wage earners up to \$40,000 annually. The accounts would be funded by 3 percent of pay and a government match, financed by general revenues for low wage workers. In the case of disabled workers, general revenues would be used to provide both the worker contribution (3 percent) and the matching contribution. The accounts would have the same tax treatment as Roth IRAs.

Preserving Our Promise to Seniors Act of 2010

Representative Ted Deutch of Florida introduced H.R. 5834, *Preserving Our Promise to Seniors Act*, on July 22, 2010. The legislation has three main provisions that directly affect the Social Security Trust Funds. First, base the Cost of Living Adjustment (COLA) for Social Security benefits on the Consumer Price Index for the Elderly (CPI-E), which is currently an experimental measure maintained by the Department of Labor. As discussed earlier in this report the CPI-E tends to rise faster than the currently used CPI-W and thus would be expected to result in larger annual COLAs. Second, apply the payroll tax to all covered earnings, phased in from 2011 to 2017. This would remove the current cap on earnings subject to the Social Security payroll tax known colloquially as the taxable maximum and officially as the “contribution and benefit base.” Third, for the purposes of calculating benefits, earnings above the current law “contribution and benefit base” now subject to payroll tax would be credited for the purpose of calculating benefits according to a new formula. Monthly benefits would include 3 percent of the first \$11,933 of average indexed monthly earnings (AIME) above the current taxable maximum, and 0.25 percent of any earnings above that threshold. The threshold would be indexed to the average wage index (AWI) in the same way as is done for the current law table maximum. An additional provision of the legislation would establish special relief payments of \$250 (indexed to CPI-E) in years when there is no COLA, but these funds would not come from the OASDI Trust Funds.

Social Security Personal Savings Guarantee and Prosperity Act of 2010, Title IV of the Roadmap for America’s Future Act of 2010

Representative Paul Ryan of Wisconsin introduced H.R. 4529 on January 27, 2010. Title IV of that legislation would modify both benefit and revenue provisions of Social Security and establish voluntary carve-out individual accounts.

Provisions that affect benefits. (1) Alter the PIA benefit formula with progressive price indexing for all earners above the 30th percentile of the AIME. This would reduce benefit growth for future generations and the gap between the new (post policy) benefits and currently scheduled benefits would become larger for successive birth cohorts. In addition, within each birth cohort, reductions in benefit growth would be largest for those earning at or above the taxable maximum, with the reductions becoming smaller for workers with smaller career-average earnings, and smallest for those just above the 30th percentile of career-average earners. Below the 30th percentile of career earners, the current benefit formula would be unaltered. The reduction would not apply to disability or auxiliary benefits, but would apply on a proportional basis to disabled worker beneficiaries upon their conversion to retired worker status at the attainment of their full retirement age. (2) Increase benefits for low earners. Specifically, increase benefits due at the full retirement age to 120 percent of the federal poverty line for workers with 30 years of earnings at an average wage-indexed level equivalent to the full-time annual minimum wage for 2009. (3) Accelerate the current-law increase in the full retirement age to 67 by one year. The full retirement age would reach 67 for those attaining age 62 in 2021 instead of 2022. After 2021 index the retirement age for longevity, raising it at the rate necessary to maintain the ratio of life expectancy at the full retirement age to the difference between the full retirement age and 20.

Provisions that affect revenues. (1) Applying the OASDI payroll tax to the total premium cost of employer sponsored health insurance. Any cost toward such group health insurance borne by employees would cease to be deductible, and the cost borne by employers would now be allocated to employees as

if it had been wages, for the purpose of payroll tax (and later, benefit) calculations. Both employee and employer OASDI payroll taxes would be affected by this proposal. (2) Provide special general revenue transfers as needed to assure Trust Fund solvency, and provide for special transfers back to the General Fund of the Treasury that would offset any prior general revenue transfers as long as Trust Fund solvency is maintained.

The plan would establish voluntary, progressive individual accounts by allowing workers who are under age 55 on January 1, 2011 (those born in 1956 or later) to have a portion of their payroll taxes transferred to a personal savings account. At retirement, the participating worker would be required to purchase a life annuity with CPI-indexed payments using the portion of account's accumulated assets necessary to provide a total monthly payment (including any OASDI monthly benefit under the plan) that is at least equal to 150 percent of the federal poverty level. Social Security retired worker benefits of individual account participants would be reduced with the reduction reflecting the degree of participation over their entire career. Individuals who participate in the personal savings account would be guaranteed that their account balance at annuitization would not be less than their contributions accumulated by the rate of inflation, as measured by the CPI-W, with any shortfall between the account balance and the guaranteed amount provided from the OASI Trust Fund.

Reports of Commissions addressing long-term fiscal reform

As this report was being finalized several organizations released reports recommending ways to address the long-term fiscal challenges of the United States, including ways to address the long-term solvency of the Social Security program. For the benefit of our readers, but without any implication that the Advisory Board endorses either proposal, we outline, below, the major provisions included in the final report of the National Commission on Fiscal Responsibility and Reform, and the report of the Debt Reduction Task Force of the Bipartisan Policy Center.

The report of the **National Commission on Fiscal Responsibility and Reform** (December 2010) contains eight separate provisions that have significant effects on the OASDI program financial operations and actuarial status.⁴³

1. "After 2022, index the normal retirement age (NRA) to maintain a constant ratio of (a) life expectancy at NRA to (b) potential work years (NRA-20). Maintain the earliest eligibility age (EEA) at NRA-5. Increases in the EEA and NRA would be limited. Consistent with this intent, the following provision is included as a potential limitation. For individuals who have earned four quarters of coverage in 25 years before age 62, retain the EEA and NRA at 62 and 67, respectively, if the AIME is under 250 percent of aged poverty (wage indexed from 2009), with this limitation phased out completely if AIME is over 400 percent of aged poverty.

⁴³ For a copy of the memo from the Social Security Administration's Office of the Chief Actuary that describes and estimates the financial impact of the provisions of the National Commission on Fiscal Responsibility and Reform's proposals on Social Security see http://www.ssa.gov/oact/solvency/FiscalCommission_20101201.pdf. The Commission's final report can be found at <http://www.fiscalcommission.gov/>.

2. Create a new bend point in the PIA formula at the AIME for the 50 percentile of new retired worker awards. Over the period 2017-2050, gradually reduce the 32 percent PIA factor that applied below the new bend point to 30 percent, the 32 percent PIA factor that applies above the new bend point to 10 percent, and the 15 percent PIA factor to 5 percent.
3. Change the OASDI cost of living adjustment (COLA) to be based on a chained version of the Consumer Price Index (CPI-W) starting for December 2011.
4. Beginning in 2017, increase the special minimum benefit by making the following changes. (a) A year of coverage is defined as a year in which four quarters of coverage are earned. (b) The minimum PIA for 30 years of coverage is equal to 125 percent of the monthly poverty level (indexed by chained CPI from 2009 to 2017 and by average wage thereafter, for successive cohorts). (c) The minimum PIA is zero for 10 or fewer years of coverage, and increases linearly for 11 through 30 years of coverage. (d) Scale year of coverage requirements for disabled workers based on years of potential work.
5. Effective for all beneficiaries in 2011 and later, provide a 5 percent increase in PIA phased in over the 20th through 24th years after initial benefit eligibility. The total increase in PIA is 5 percent of the PIA for a worker of the same age with earnings at the average (AWI) at ages 22 through 61.
6. Increase the OASDI contribution and benefit base (taxable maximum) by an additional 2 percent each year starting in 2012, until 90 percent of covered earnings are taxable. Additional increases are expected for 38 years, reaching 90 percent taxable for 2049 and later. Establish starting in 2013 a new PIA bend point at the monthly equivalent of the taxable maximum that would be determined without regard to this provision, with a benefit formula factor of 5 percent for AIME above this new bend point.
7. Allow retirees to start receiving up to one-half of their benefits at age 62, with applicable actuarial reductions. The remainder is not available for take-up until EEA and actuarial reduction is applied.
8. Cover earnings of all state and local government employees hired in 2021 and later.”

The report of the **Bipartisan Policy Center’s Debt Reduction Task Force** (November 2010)⁴⁴ contains 11 separate provisions that have significant effects on the OASDI program financial operations and actuarial status:

1. “Increase the OASDI contribution and benefit base over 38 years starting in 2012, so that 90 percent of covered earnings will be taxable for 2049 and later.
2. Change the OASDI cost of living adjustment (COLA) to be based on a chained version of the Consumer Price Index for Urban Wage and Clerical Workers (CPI-W) starting for December 2012.
3. Cover earnings of all state and local government employees hired in 2020 and later under OASDI.
4. Eliminate the excise tax on premiums for employer sponsored group health insurance and make all such premiums subject to OASDI payroll tax, phased in between 2018 and 2028.
5. Reduce the 15 percent PIA formula factor to 10 percent, phased in gradually between 2023 and 2052.
6. Starting in 2012, enhance the special minimum benefit to provide a PIA level at benefit eligibility equivalent to 133 percent of the 2009 Federal Aged Poverty threshold for individuals with earnings of at least 20 percent of the “old-law taxable maximum” in at least 30 years. The minimum would be reduced for fewer qualifying years, to zero for less than 20 years. The target poverty level would be wage indexed from the 2009 level to two years before the year of initial benefit eligibility. Up to eight childcare creditable years would be allowed if caring for a child under age 6. The earnings requirement and number of child care creditable years allowed would be scaled for workers becoming disabled or dying before attaining age 62.
7. Subject contributions to all voluntary salary reduction plans to OASDI payroll tax in the same manner as for 401(k)s.

⁴⁴ For a copy of the memo from the Social Security Administration’s Office of the Chief Actuary that describes and estimates the financial impact of the provisions of the Bipartisan Policy Center’s Debt Reduction Task Force proposals on Social Security see http://www.ssa.gov/oact/solvency/BipartisanTaskForce_20101117.pdf. The Task Force’s final report can be found at <http://www.bipartisanpolicy.org/>.

8. Index the PIA formula for OASI benefits to longevity by reducing the factors starting in 2023 by the change in the ratio of (a) the period life expectancy at 67 for 2018 to (b) the period life expectancy at 67 for the fourth year before initial benefit eligibility. For disabled workers at conversion to retirement at NRA, the reductions would apply based on the proportion of years not disabled from 22 to 61.
9. Increase benefits gradually between ages 81 and 85 reflecting an increase in PIA equal to 5 percent of the average retired worker PIA in the year age 80 is reached.
10. Tax Reform for Business: Establish a value added tax of 3.0 percent for 2012 and 6.5 percent for 2013 and later. Reduce the corporate income tax from 35 to 27 percent.
11. Tax Reform for Individuals: Modify the personal income tax to make two brackets with marginal rates of 15 and 27 percent. OASDI benefits are included as regular income with no thresholds. Capital gains are included as regular income. A non-refundable credit for low income tax filers age 65 and older is established. A non-refundable credit of 7.5 percent of OASDI benefit is established. Thus, revenue to OASDI is based on 7.5 and 19.5 percent marginal rates on all OASDI benefits."

APPENDICES

APPENDIX I: Options to Address OASDI Solvency

Each of the policy options included in this report have been scored and described in more detail on the website of the Social Security Administration's Office of the Chief Actuary. The letter and number combination in the column labeled OACT # references the equivalent solvency provision on the Actuary's website. (See <http://www.ssa.gov/OACT/solvency/provisions/summary.html>.)

	Impact of Proposal On:				
	Cumulative 75 Year Deficit (2009-2084)		Annual Balance in the 75th Year (2084)		
OPTIONS TO ADDRESS OASDI SOLVENCY:	<i>-2.00% of taxable payroll</i>		<i>-4.34% of taxable payroll</i>		
	As percent of taxable payroll	As percent of 2.00% deficit	As percent of taxable payroll	As percent of 4.34% deficit	OACT #
<u>OPTIONS THAT REDUCE BENEFITS</u>					
Options to increase the career earnings averaging period					
OPTION 1: Increase the career averaging period to 38 years	0.29	15%	0.43	10%	B4.1
OPTION 2: Increase the career averaging period to 40 years	0.46	23%	0.72	17%	B4.2
OPTION 3: Increase the career averaging period to 40 years and apply to disabled worker benefits	0.63	32%	1.02	24%	B4.3
Options to reduce initial benefits across the board					
OPTION 4: Reduce initial benefits by 3 percent	0.36	18%	0.50	12%	B6.1
OPTION 5: Reduce initial benefits by 5 percent	0.61	31%	0.84	19%	B6.2
Options to the change the rules for indexing initial benefits					
OPTION 6: Index new benefits to prices rather than wages	2.28	114%	7.16	165%	B1.1
OPTION 7a,b,c: Progressive price indexing					
7a For top 70 percent of earners	1.31	66%	3.97	91%	B1.2
7b For top 60 percent of earners	1.10	55%	3.32	76%	B1.3
7c For top 40 percent of earners	0.61	31%	1.57	36%	B1.5
OPTION 8: Progressive indexing for top 70 percent of earners	1.34	67%	3.33	77%	B3.6
OPTION 9: Index initial benefits to life expectancy	0.56	28%	1.93	44%	B2.1
Options to gradually reduce initial benefits by reducing PIA factors					
OPTION 10: Gradually reduce top two PIA formula factors for new beneficiaries to 21 and 10 percent	1.51	76%	2.94	68%	B3.1
OPTION 11a,b: Gradually reduce all three PIA factors					
11a Reduce to 69.2, 24.6 and 11.5 by 2041	1.45	73%	3.11	72%	B3.4
11b Reduce to 67.6, 24.6 and 11.5 by 2054	2.03	102%	5.31	122%	B3.2
Options to reduce the Social Security cost-of-living adjustment (COLA)					
OPTION 12: Reduce COLA by 1 percent	1.55	78%	2.19	50%	A1
OPTION 13: Reduce COLA by 0.5 percent	0.81	41%	1.15	26%	A2
OPTION 14: Adopt “chained” CPI as basis for COLA	0.49	25%	0.70	16%	A3
OPTION 15: Adopt “chained” CPI as basis for COLA, but do not apply to disabled worker benefits	0.36	18%	0.50	12%	A4

	Impact of proposal on:				
	Cumulative 75 Year Deficit (2009-2084)		Annual Balance in the 75th Year (2084)		
OPTIONS TO ADDRESS OASDI SOLVENCY:	<i>-2.00% of taxable payroll</i>		<i>-4.34% of taxable payroll</i>		
	As percent of taxable payroll	As percent of 2.00% deficit	As percent of taxable payroll	As percent of 4.34% deficit	OACT #
<u>OPTIONS THAT INCREASE RETIREMENT AGES</u>					
OPTION 16: Speed up the scheduled increase in FRA to 67	0.09	4%	0.00	0%	C1.1
OPTION 17: Speed up increase to 67 then raise the FRA to 68	0.46	23%	0.73	17%	C1.2
OPTION 18: Speed up increase to 67 then raise the FRA to 70	0.62	31%	1.43	33%	C1.3
OPTION 19: Index retirement ages to life expectancy	0.41	21%	1.23	28%	C1.6
OPTION 20: Increase the EEA along with FRA	0.56	28%	1.23	28%	C2.2
OPTION 21: Convert disability benefits to retirement at the EEA	0.36	18%	0.73	17%	C2.3
<u>OPTIONS THAT INCREASE REVENUES</u>					
Options to raise Social Security payroll tax rates					
OPTION 22:Raise payroll taxes by 2.2 percent in 2010	2.09	105%	2.19	50%	E1.1
OPTION 23: Raise payroll taxes by 2 percent in 2022 and 2052	2.06	103%	3.92	90%	E1.2
OPTION 24: Raise taxes rates by 0.1 percent per year for 20 years	1.39	70%	1.98	46%	E1.4
OPTION 25: Return to pay-as-you-go financing with 100 percent Trust Fund ratio		100%		100%	
Options to raise the cap on earnings subject to the Social Security tax					
OPTION 26: Eliminate cap, but do not count earnings	2.32	116%	2.49	57%	E2.1
OPTION 27: Eliminate the cap, and count earnings	1.89	95%	1.65	38%	E2.2
OPTION 28: Eliminate the cap, and count smaller fraction earnings	2.17	109%	2.19	50%	E2.9
OPTION 29: Raise the cap to 90 percent of earnings, do not count earnings	0.94	47%	1.07	25%	E2.4
OPTION 30: Raise the taxable maximum to include 90 percent of all covered earnings, and count additional earnings towards benefits	0.75	38%	0.62	14%	E2.3
OPTION 31: Eliminate cap for employers, raise to include 90 percent of earnings for employees and benefit calculations	1.41	71%	1.39	32%	E2.11
OPTION 32: Raise cap to apply to all earnings of 95 percent of covered workers	0.11	6%	0.08	2%	E2.7
OPTION 33a,b: Apply an tax on earnings above the cap					
a Tax earnings above cap at 3 percent, do not increase benefits	0.57	29%	0.61	14%	E2.6
b Tax earnings above cap at 6 percent, do not increase benefits	1.12	56%	1.20	28%	E2.8

	Impact of Proposal On:				
	Cumulative 75 Year Deficit (2009-2084)		Annual Balance in the 75th Year (2084)		
OPTIONS TO ADDRESS OASDI SOLVENCY:	<i>-2.00% of taxable payroll</i>		<i>-4.34% of taxable payroll</i>		
	As percent of taxable payroll	As percent of 2.00% deficit	As percent of taxable payroll	As percent of 4.34% deficit	OACT #
Options to extend Social Security coverage of employment or earnings					
OPTION 34: Cover newly hired State and local government workers	0.17	9%	-0.17	-4%	F1
OPTION 35: Subject employer provided group health benefits to OASDI payroll tax	1.13	57%	0.97	22%	F2
Option to increase the portion of Social Security benefits subject to the income tax					
OPTION 36: Tax Social Security benefits like private pensions	0.28	14%	0.16	4%	H1/H2
OTHER OPTIONS					
Options to invest Social Security reserves in marketable securities					
OPTION 37a,b,c: Invest 40 percent of Trust Fund in equities					
a Assuming real return of 6.4	0.67	34%	0.00	0%	G1
b Assuming real retun of 5.4	0.48	24%	0.00	0%	G2
c Assuming real return of 2.9 equal to Treasury Bonds	0.00	0%	0.00	0%	G3
OPTION 38a,b: Invest 15 percent of Trust Fund in equities					
a Assuming real return of 6.4	0.27	14%	0.00	0%	G4
b Assuming real return of 2.9 equal to Treasury Bonds	0.00	0%	0.00	0%	G5
Options to create individual investment accounts					
OPTION 39: Carve-out individual investment accounts	0.00	0%	0.00	0%	
OPTION 40: Add-on individual investment accounts	0.00	0%	0.00	0%	

APPENDIX II: Recent Proposals for Which Detailed Estimates Have Been Published by the Office of the Chief Actuary, Social Security Administration

See full text of estimates at <http://www.ssa.gov/OACT/solvency/index.html>

- December 1, 2010. Estimates of the OASDI financial effects of the plan developed by the National Commission on Fiscal Responsibility and Reform.
- November 17, 2010. Estimates of the OASDI Financial Effects of Restoring America's Future – a plan developed by the Bipartisan Policy Center's Debt Reduction Task Force.
- October 8, 2010. Deutch – *Preserving Our Promise to Seniors Act* – legislation introduced as H.R. 5384 (111th Congress) on July 22, 2010 by Representative Ted Deutch.
- May 18, 2010. Estimated financial effects of two Social Security reform options requested by the Senate Special Committee on Aging for inclusion in its committee report, *Social Security Modernization: Options to Address Solvency and Benefit Adequacy*.
- April 27, 2010. Ryan – Estimated financial effects of Title IV of *The Roadmap for America's Future Act of 2010* – legislation introduced as Title IV of H.R. 4529 (111th Congress) on January 27, 2010 by Representative Paul Ryan.
- January 13, 2010. National Research Council and the National Academy of Public Administration – Estimated financial effects of four comprehensive proposals to restore Social Security to sustainable solvency requested by the National Research Council and the National Academy of Public Administration for their committee report, *Choosing the Nation's Fiscal Future*.
- October 30, 2009. National Academy of Social Insurance – Estimated financial effects of several Social Security reform options requested by the National Academy of Social Insurance for its report, *Fixing Social Security: Adequate Benefits, Adequate Financing*.
- July 2, 2009. Wexler – Estimated financial effects of the *Social Security Forever Act of 2009* – legislation introduced as H.R. 1863 (111th Congress) on April 1, 2009 by Representative Robert Wexler.
- February 12, 2009. Bennett – Estimated financial effects of the *Social Security Solvency Act of 2009* – legislation introduced as S. 426 (111th Congress) on February 12, 2009 by Senator Robert Bennett.
- September 17, 2008. Warshawsky – Estimated financial effects of "A Reform Proposal to Make Social Security Financially Sound, Fairer, and More Progressive" – a proposal developed by Mark Warshawsky.
- June 19, 2008. AARP estimated financial effects of several reform options.
- May 21, 2008. Ryan – Estimated financial effects of the *Social Security Personal Savings Guarantee and Prosperity Act of 2008* – legislation introduced as Title IV of H.R. 6110 (110th Congress) on May 21, 2008 by Representative Paul Ryan.
- March 16, 2006. Bennett – Estimated financial effects of a proposal to *Restore Sustainable Solvency for the Social Security Program* – legislation introduced as S. 2427 (109th Congress) on March 16, 2006 by Senator Robert Bennett.
- November 17, 2005. Liebman, MacGuineas, Samwick – Estimated financial effects of "A Nonpartisan Approach to Reforming Social Security" – a proposal developed by Jeffrey Liebman, Maya MacGuineas and Andrew Samwick.

- November 4, 2005. Kolbe, Boyd – Estimated OASDI financial effects of the *Bipartisan Retirement Security Act of 2005* – legislation introduced as H.R. 440 (109th Congress) by Representative Jim Kolbe and Representative Allen Boyd.

APPENDIX III: Description of the 1983 Social Security Amendments

In late 1981, President Ronald Reagan and the Congress created the National Commission on Social Security – known as the Greenspan Commission after its chairman, Alan Greenspan – to study the program's financial problems and make recommendations for legislative reforms. Based on the recommendations of the Greenspan Commission, Congress passed the *Social Security Amendments of 1983* (P.L. 98-21). This legislation, signed into law on April 20, 1983, made comprehensive changes in Social Security coverage, financing, and the structure of benefits, including the following provisions:

- Raised the eligibility age for unreduced retirement benefits in two stages to 67 by the year 2027. Workers born in 1938 were the first group affected by the gradual increase. Benefits are still available at age 62, but with greater reduction.
- Advanced scheduled increases in Social Security payroll tax rates (including the Hospital Insurance (HI) tax rate) for employers and employees to 7.0 percent in 1984, to 7.05 percent in 1985, to 7.15 percent in 1986-87, to 7.51 percent in 1988-89 and to 7.65 percent in 1990 and thereafter. Also increased tax rates on self-employment income equal to the combined employee-employer rates and provided credits against tax liability to offset part of the increase.
- Extended Social Security coverage to federal employees and employees of the legislative branch not participating in the Civil Service Retirement System, all Members of Congress, the President and the Vice-President, federal judges, and other executive-level political appointees of the federal government, effective January 1, 1984.
- Also extended Social Security coverage on a mandatory basis to all employees of tax-exempt nonprofit organizations as of January 1, 1984.
- Eliminated windfall Social Security benefits for workers who are first eligible after 1985 for both a pension from non-covered employment and Social Security retirement or disability benefits.
- Provided for cost-of-living increases based on prices or wages – whichever is less – if the Trust Funds fall below a specified level.
- Made up to one half of Social Security benefits taxable for those taxpayers whose adjusted gross income, plus any nontaxable interest income, plus half their Social Security benefit that exceeds \$25,000 for a single taxpayer and \$32,000 for married taxpayers filing jointly, beginning in 1984. Benefits received by married taxpayers filing separately were made taxable without regard to other income. Appropriated amounts equal to estimated tax liability to the Social Security Trust Funds.
- Changed the earnings test for beneficiaries age 65 and over so that \$1 in benefits will be withheld for each \$3 of earnings above the annual exempt amount, beginning in 1990 (subsequent legislation in 2000 eliminated the earnings test entirely for beneficiaries after attainment of the full retirement age).
- Increased the delayed retirement credit in gradual steps from 3 percent for workers reaching full retirement age before 1990, to 8 percent for workers reaching full retirement age after 2008.
- Reauthorized inter-fund borrowing among the three Social Security Trust Funds for calendar years 1983 through 1987 with repayment by the end of 1989.
- Provided for crediting the OASDI and HI Trust Funds at the beginning of each month with revenues to be received during the month and for special reports by the Boards of Trustees in the event the Trust Fund assets fall below 20 percent of annual expenditures; and
- Required operations of the four Social Security Trust Funds to be shown as a separate function within the federal budget for FY 1985-1992 and removed operation of the OASDI and HI Trust Funds from the Unified Budget beginning in FY 1993.

Members of the Social Security Advisory Board

Barbara B. Kennelly, Acting Chair

Barbara B. Kennelly became President and Chief Executive Officer of the National Committee to Preserve Social Security and Medicare in April 2002 after a distinguished 23-year career in elected public office. Mrs. Kennelly served 17 years in the United States House of Representatives representing the First District of Connecticut. During her Congressional career, Mrs. Kennelly was the first woman elected to serve as the Vice Chair of the House Democratic Caucus. Mrs. Kennelly was also the first woman to serve on the House Committee on Intelligence and to chair one of its subcommittees. She was the first woman to serve as Chief Majority Whip, and the third woman in history to serve on the 200-year-old Ways and Means Committee. During the 105th Congress, she was the ranking member of the Subcommittee on Social Security. Prior to her election to Congress, Mrs. Kennelly was Secretary of State of Connecticut. After serving in Congress, Mrs. Kennelly was appointed to the position of Counselor to the Commissioner at the Social Security Administration (SSA). As Counselor, Mrs. Kennelly worked closely with the Commissioner of Social Security Kenneth S. Apfel, and members of Congress to inform and educate the American people on the choices they face to ensure the future solvency of Social Security. She served on the Policy Committee for the 2005 White House Conference on Aging. Mrs. Kennelly received a B.A. in Economics from Trinity College, Washington, D.C. She earned a certificate from the Harvard Business School on completion of the Harvard-Radcliffe Program in Business Administration and a Master's Degree in Government from Trinity College, Hartford. Term of office: January 2006 to September 2011.

Dana K. Bilyeu*

Dana K. Bilyeu is the Executive Officer of the Public Employees' Retirement System of Nevada. As the Executive Officer of the \$21 billion pension trust she is responsible for all aspects of fund management including analysis of plan funding, investment oversight, operational and strategic planning, and fiduciary and governance issues. Mrs. Bilyeu is principally responsible for the relationship with the System's independent actuary and oversees the data reconciliation process for actuarial valuations of the System. In her capacity as the Executive Officer, Mrs. Bilyeu provides information and analysis to the Nevada Legislature in consideration of pension policy issues affecting State and local government. Prior to her appointment as the Executive Officer, Mrs. Bilyeu served for eight years as the System's Operations Officer, overseeing all aspects of benefit administration, including survivor, disability, and retirement benefit programs. Mrs. Bilyeu also was responsible for cost effectiveness measurement for all activities of the System. She was accountable for technology oversight as well as policy issues related to the public safety sector of public employment. Prior to her employment at the System, Mrs. Bilyeu was the System's legal counsel, representing the System in a variety of aspects from benefits litigation, contracts analysis, to Board governance. Mrs. Bilyeu is a member of the National Association of State Retirement Administrators, the National Council on Teacher Retirement, the National Conference of Public Employee Retirement Systems, and the National Association of Public Pension Attorneys. She also serves on the Public Employee Advisory Board for the International Foundation of Employee Benefit Plans. She received her *juris doctor* from California Western School of Law and her B.A. from the University of Arizona. Term of office: December 2006 to September 2010.

*term expired September 30, 2010

Jagadeesh Gokhale

Jagadeesh Gokhale is a senior fellow at the Cato Institute. He earlier worked at the American Enterprise Institute as a visiting scholar (2003), the U.S. Treasury Department as a consultant (2002), and the Federal Reserve Bank of Cleveland as a senior economic advisor (1990-2003). An economist by training, his main research fields are macro and public economics with a special focus on the effects of fiscal policy on future generations. During 2008, he served as a member of the Task Force on Sustainability Issues for the Federal Accounting Standards Advisory Board. Dr. Gokhale has written extensively on policy issues including Social Security and Medicare reform, national saving, private insurance, financial planning, wealth inequality, generational accounting, and public intergenerational transfers and he has testified several times before Congress on these topics. He has published several papers in such top-tier journals as the *American Economic Review*, *Journal of Economic Perspectives*, *Quarterly Journal of Economics*, *Review of Economics and Statistics*; in publications of the National Bureau of Economic Research and the Cleveland Federal Reserve; in the US Budget report's *Analytical Perspectives*; and in popular newspapers and online media such as the *Wall Street Journal*, *The Financial Times*, *The Washington Post*, *American Spectator*, and *Forbes*. Dr. Gokhale is a co-author of *Fiscal and Generational Imbalances* that revealed the U.S. fiscal imbalance to be in the tens of trillions of dollars. Another book by him entitled *Social Security: A Fresh Look at Policy Alternatives* is forthcoming from the University of Chicago Press in 2010. Term of Office: November 2009 to September 2015.

Dorcas R. Hardy

Dorcas R. Hardy is President of DRHardy & Associates, a government relations and public policy firm serving a diverse portfolio of clients. After her appointment by President Ronald Reagan as Assistant Secretary of Human Development Services, Ms. Hardy was appointed Commissioner of Social Security (1986 to 1989) and was appointed by President George W. Bush to chair the Policy Committee for the 2005 White House Conference on Aging. Ms. Hardy has launched and hosted her own primetime, weekly television program, "Financing Your Future," on Financial News Network and UPI Broadcasting, and "The Senior American," an NET political program for older Americans. She speaks and writes widely about domestic and international retirement financing issues and entitlement program reforms and is the co-author of *Social Insecurity: The Crisis in America's Social Security System* and *How to Plan Now for Your Own Financial Survival*, Random House, 1992. A former CEO of a rehabilitation technology firm, Ms. Hardy promotes redesign and modernization of the Social Security, Medicare, and disability insurance systems. Additionally, she has chaired a Task Force to rebuild vocational rehabilitation services for disabled veterans for the Department of Veterans Affairs. She received her B.A. from Connecticut College, her M.B.A. from Pepperdine University, and completed the Executive Program in Health Policy and Financial Management at Harvard University. Ms. Hardy is a Certified Senior Advisor and serves on the Board of Directors of Wright Investors' Service Managed Funds, and First Coast Service Options of Florida. First term of office: April 2002 to September 2004. Current term of office: October 2004 to September 2010.

Marsha Rose Katz

Marsha Rose Katz is a Project Director at the University of Montana Rural Institute in Missoula, where her work has concentrated on assisting persons with disabilities to utilize Social Security work incentives to start their own businesses or engage in wage employment. Since coming to the Rural Institute in 1999, Ms. Katz has focused on providing training and technical assistance on both employment and SSI/SSDI to rural, frontier and tribal communities across the country. Previously, she worked for nearly 20 years in a disability rights community based organization, the Association for Community Advocacy (ACA), a local Arc in Ann Arbor, Michigan. She served as both Vice President of ACA, and Director of its Family Resource Center. It was at ACA that Ms. Katz began her nearly 30 years of individual and systems advocacy regarding programs administered by SSA, especially the SSI and SSDI programs. Ms. Katz has written numerous articles and created many widely distributed user-friendly general handouts on SSI and SSDI, the majority of which focus on the impact of work on benefits, and utilizing work incentives. She is the author of *Don't Look for Logic; An Advocate's Manual for Negotiating the SSI and SSDI Programs*, published by the Rural Institute. Her Bachelor's and Master's Degrees are from the University of

Michigan. Ms. Katz's many years of experience as a trainer, technical advisor, and advocate have been guided and informed by her partnership with people with disabilities, from her husband, Bob Liston, to the people she assisted in her work with ACA and the Arc Michigan, her current work at the Rural Institute, and her longstanding participation in ADAPT, the nation's largest cross-disability, grassroots disability rights organization. Term of office: November 2006 to September 2012.

Mark J. Warshawsky

Mark J. Warshawsky is Director of Retirement Research at Towers Watson, a global human capital consulting firm. He conducts and oversees research on employer-sponsored retirement programs and policies. A frequent speaker to business and professional groups, Dr. Warshawsky is a recognized thought leader on pensions, social security, insurance and healthcare financing. He has written numerous articles published in leading professional journals, books and working papers, and has testified before Congress on pensions, annuities and other economic issues. A member of the Social Security Advisory Board for a term through 2012, he is also on the Advisory Board of the Pension Research Council of the Wharton School. From 2004 to 2006, Dr. Warshawsky served as assistant secretary for economic policy at the U.S. Treasury Department. During his tenure, he played a key role in the development of the Administration's pension reform proposals, particularly pertaining to single-employer defined benefit plans, which were ultimately included in the Pension Protection Act ("PPA") of 2006. He was also involved extensively in the formulation of Social Security reform proposals, and oversaw the Department's comprehensive 2005 study of the terror risk insurance program. In addition, Dr. Warshawsky led the efforts to update and enhance substantially the measures and disclosures in the Social Security and Medicare Trustees' Reports, as well as the setting of the macroeconomic forecasts, which underlie the administration's budget submissions to Congress. Dr. Warshawsky's research has been influential in the 2001-2002 regulatory reform of minimum distribution requirements for qualified retirement plans, the increasing realization of the importance of financial protection against outliving one's financial resources in retirement, and a product innovation to integrate the immediate life annuity and long-term care insurance. For the latter research, he won a prize from the British Institute of Actuaries in 2001 for a professional article he co-authored. Favorable tax treatment for this integrated product was also included in PPA due to Dr. Warshawsky's advocacy. Dr. Warshawsky has also held senior-level economic research positions at the Internal Revenue Service, the Federal Reserve Board in Washington, D.C. and TIAA-CREF, where he established the Paul A. Samuelson Prize and organized several research conferences. A native of Chicago, he received a Ph.D. in Economics from Harvard University and a B.A. with Highest Distinction from Northwestern University. Term of office: December 2006 to September 2012.

Legislation that Established the Social Security Advisory Board

In 1994, when Congress passed Public Law 103-296 establishing the Social Security Administration as an independent agency, it also created an independent, bipartisan Advisory Board to advise the President, the Congress, and the Commissioner of Social Security on matters related to the Social Security and Supplemental Security Income programs. Under this legislation, appointments to the Board are made by the President, the Speaker of the House of Representatives, and the President pro tempore of the Senate.

Advisory Board members are appointed to staggered six year terms, made up as follows: three appointed by the President (no more than two from the same political party); and two each (no more than one from the same political party) by the Speaker of the House (in consultation with the Chairman and the Ranking Minority Member of the Committee on Ways and Means) and by the President pro tempore of the Senate (in consultation with the Chairman and Ranking Minority Member of the Committee on Finance). Presidential appointments are subject to Senate confirmation. The President designates one member of the Board to serve as Chairman for a four year term, coincident with the term of the President, or until the designation of a successor.

The Board's Mandate

Public Law 103-296 as amended gives the Board the following functions;

- 1) Analyzing the Nation's retirement and disability systems and making recommendations with respect to how the Old-Age, Survivors, and Disability Insurance (OASDI) programs and the Supplemental Security Income (SSI) program, supported by the other public and private systems, can most effectively assure economic security;
- 2) studying and making recommendations relating to the coordination of programs that provide health security with programs described in paragraph (1);
- 3) making recommendations to the President and to the Congress with respect to policies that will ensure the solvency of the old-age, survivors, and disability insurance program, both in the short-term and the long-term;
- 4) making recommendations with respect to the quality of service that the Administration provides to the public;
- 5) making recommendations with respect to policies and regulations regarding the old-age, survivors, and disability insurance program and the supplemental security income program;
- 6) increasing public understanding of the social security system;
- 7) making recommendations with respect to a long-range research and program evaluation plan for the Administration; and
- 8) reviewing and assessing any major studies of social security as may come to the attention of the Board; and
- 9) making recommendations with respect to such other matters as the Board determines to be appropriate.

Social Security Advisory Board Staff Members

Katherine Thornton, Staff Director

Katherine Thornton joined the Advisory Board as the Deputy Staff Director in 2005. Before coming to the Board, she held several senior management positions in the Social Security Administration. From 1995-2002, she was the Director of the Center for Disability Programs in the Philadelphia region before relocating to SSA's Baltimore headquarters. While in headquarters, Ms. Thornton was a member of the Senior Executive Service candidate development program, and had a series of assignments including a leadership role for the Agency's eDib project, as well as serving as a program manager with the International Social Security Association in Geneva Switzerland. She holds a Bachelor's Degree in Sociology and Social Work from Western Michigan University.

Deborah Sullivan, Deputy Staff Director

Deborah (Debi) Sullivan joined the Social Security Advisory Board staff in September 2007 as the Deputy Staff Director. Before joining the Board staff, she was a participant in the Social Security Administration's (SSA's) Senior Executive Service Candidate Program and did extensive work on the agency's most recent disability service improvement initiatives. Ms. Sullivan began working for SSA as a claims representative in Columbus, Indiana in 1978 and has held increasingly more responsible supervisory and managerial positions throughout her career. She worked in a number of SSA field offices and the Regional Offices in both Chicago and Atlanta. In 2002, she relocated to SSA's headquarters in Baltimore to become the Executive Officer of SSA's strategic planning component, which was responsible for the publication of the agency's annual planning documents and periodic strategic plans. During her tenure at the Social Security Administration, Ms. Sullivan was the recipient of many awards including five Commissioner's Citations and a National Performance Award. She holds a Bachelor's Degree in History and Political Science from Ball State University and has completed additional graduate work at Emory University in Atlanta.

Joel A. Feinleib, Staff Economist

Joel Feinleib joined the Advisory Board as Staff Economist in 2005 focusing on long-term financing issues, reform proposals, and empirical research. He previously worked as a research consultant and policy analyst in Washington D.C. and Chicago specializing in the economic, demographic and statistical analysis of social policy issues including welfare policy, drug control policy, environmental health and HIV/AIDS prevention. He holds a B.S. in Economics from The Wharton School, University of Pennsylvania and a Masters in Public Policy Studies from the University of Chicago.

Beverly Rollins Sheingorn, Executive Officer

Beverly Rollins Sheingorn began her career with the Federal Government as a claims representative for the Social Security Administration in the Rockville, Maryland field office. She held a number of jobs with SSA, including senior executive analyst for both the Associate Commissioner of Hearings and Appeals and the Deputy Commissioner for Programs. In 1995, she worked with the National Commission on Childhood Disability, serving as an executive assistant to the Staff Director. Prior to working for the Federal Government, Ms. Rollins Sheingorn worked as a social worker for the Head Start program and the West Virginia Department of Welfare. Since joining the Board staff in 1996, she has served as Executive Officer. She holds a Bachelor's degree in Social Work from West Virginia University and a Master's degree in General Administration from the University of Maryland.

George Schuette, Professional Staff

Before joining the Advisory Board staff in 1999, George Schuette worked for the Kentucky Department for Human Resources and the Social Security Administration, taught in colleges, and served in the U.S. Army. He began working for SSA as a generalist claims representative in Cincinnati in 1977. In 1980 he

moved to Baltimore to work in the Office of Training. He worked in staff and management positions in a variety of areas, including analyst training, management training, programmatic training, evaluation, and career development. He was involved in the introduction of new technologies to the agency, including personal computers, computer-based training, and interactive video. He has a Ph.D. in history from Duke University.

Roberta (Robin) Walker, Staff Assistant

Robin Walker joined the Advisory Board staff in December 2009 after spending many years as an Executive Assistant in the public sector. Most recently she supported the work of the President and Vice President of a D.C. construction firm. Ms. Walker has years of experience in managing all aspects of a corporate office.

David Warner, Professional Staff

David Warner began his career with the Federal Government in 1988 as a budget and program analyst for the Office of the Secretary of the Department of Health and Human Services in Washington, D.C. He worked principally on the administrative budget for the Medicare program and the program and administrative budgets for Medicaid and the Social Security Administration. Mr. Warner transferred to the Social Security Administration in 1995. Until 1998, he served as a senior social insurance specialist and executive officer for the Deputy Commissioner for Legislation and Congressional Affairs. In 1998, Mr. Warner completed a developmental assignment as professional staff to the Social Security Subcommittee of the House Committee on Ways and Means. Since joining the staff of the Social Security Advisory Board in 1999, he has served as professional staff to the Board. He holds a Bachelor's degree in psychology from the University of Wisconsin and a Master's degree in public sector and non-profit financial management from the University of Maryland.

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